



SURGERY PARTNERS
2020 Annual Report



Fellow Stockholders,

On behalf of the Surgery Partners' team, we hope this letter finds you and your families well and healthy. At Surgery Partners, it is our mission to enhance patient quality of life through partnership. The pandemic challenges of 2020 provided us with a unique opportunity to deliver on this mission and to illustrate the value of our strategy and business model.

We are humbled by the efforts of our colleagues and physician partners that supported the healthcare system and the needs of our patients during this crisis. When we could not know what the future held, these brave individuals were on the front lines serving the critical needs of a heavily burdened healthcare system while supporting our patients and communities. As a company, we continue to be uniquely positioned during the pandemic, where our free-standing, purpose-built facilities are, more than ever before, a safe haven for physicians and patients who were seeking surgical care.

In partnership with exceptional physicians, our key differentiator has always been our relentless focus on what matters most – clinical quality and patient satisfaction. Clinical quality is our highest priority and a critical element of what our approximately 4,000 affiliated physicians and 10,000 colleagues focus on every day. I am proud to report that we continue to achieve excellent clinical quality scores relative to industry benchmarks, evidenced by numerous awards and designations as well as the fact that 100% of our short stay surgical hospitals received four or five-star patient experience star ratings from the Centers for Medicare and Medicaid Services ("CMS"). In comparison, only 40% of all hospitals received a four or five-star patient experience rating from CMS. Additionally, our ASCs continue to achieve excellent patient experience scores, averaging over 94% in our most recent surveys.

Over the past three years, we have been positioning our Company for this moment in time. The fundamentals of our business are incredibly strong, with a \$150 billion total addressable market. After navigating through the uncertainties of 2020, we have entered 2021 as a stronger, leaner, more resilient company that is well-positioned for accelerated growth in the near, mid and long-term.

Select highlights from 2020:

- We accelerated our organic growth engine through expanding and enhancing high acuity service lines and continuing to refine our operating system, resulting in same store facility revenue growth of 5.8% during the fourth quarter of 2020 compared to the same prior year period. This growth underscores our ability to execute on our key value-added initiatives across the enterprise.

- Even with the impact from COVID-19, we increased the number of total joint replacement procedures by 96% in our ASCs.
- Our physician recruiting efforts continued despite the pandemic as we recruited over 560 new physicians to our facilities. We are not only encouraged by the recruiting success of our 2020 cohort but also by the performance of our 2019 cohort in 2020 that contributed 37% more cases year over year.
- We are re-accelerating the pace of capital deployment. Over the course of 2020, we deployed approximately \$160 million acquiring 10 facilities and have refocused our portfolio on growing short-stay surgical assets. We also increased our installed base of robotics in our ASCs by almost 60% to enhance musculoskeletal growth and have plans to further expand in 2021. Since 2018, we have been reallocating dollars from lower growth, non-core assets into core surgical facilities with higher growth opportunities. In 2021, we are well positioned to play offense and to capitalize on the \$150 billion addressable market that we believe we are uniquely positioned to capture. We now have the financial capacity to execute on over \$400 million of transactions. Our teams are patient and diligent, and we believe that we can effectively deploy our capital over time at multiples that will create substantial value for our shareholders. Additionally, our new hospital in Idaho Falls is expected to become profitable in the second half of 2021 and is projected to generate over \$25 million of run-rate Adjusted EBITDA in the coming years.

As one of the largest standalone, independent surgical services company, Surgery Partners occupies a unique position in today's marketplace. We are preferred by patients, providers and payors. Our patient experience metrics support that we are focusing on the right areas and delivering exceptional patient care. Our business model aligns with and empowers physicians, providing them with the resources they need to be doctors first and to provide the best possible care for their patients. And, our unwavering focus on reducing waste and cost in the healthcare system helps payors bend the cost curve by delivering superior value as compared to traditional acute care settings.

The pandemic has created many obstacles, but it has also accelerated some of the tailwinds we had been anticipating and are positioning the company to capitalize upon. Our management team has a proven track record of execution that our 2020 results only emphasize. We are a trusted partner of choice and believe we're in the right space with the right product at the right time, setting up the runway for both near, mid and long-term double-digit growth.

Thank you for your continued support and investment in Surgery Partners.

/s/ J. Eric Evans

Eric Evans
Chief Executive Officer

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2020

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 001-37576

Surgery Partners, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

47-3620923

(I.R.S. Employer
Identification No.)

**310 Seven Springs Way, Suite 500
Brentwood, Tennessee 37027**

(Address of principal executive offices and zip code)

(615) 234-5900

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01 per share	SGRY	The Nasdaq Global Select Market

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company (each as defined in Exchange Act Rule 12b-2).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant based on the closing price of the shares of common stock on The Nasdaq Stock Market on June 30, 2020, was \$255.9 million. As of March 3, 2021, there were 59,859,614 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the 2021 annual meeting of stockholders are incorporated by reference into Part III of this report.

SURGERY PARTNERS, INC.
FORM 10-K
TABLE OF CONTENTS

	<u>Page</u>
PART I	
Item 1. Business	1
Item 1A. Risk Factors	16
Item 1B. Unresolved Staff Comments	38
Item 2. Properties	38
Item 3. Legal Proceedings	38
Item 4. Mine Safety Disclosures	38
PART II	
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	39
Item 6. Selected Financial Data	41
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	41
Item 7A. Quantitative and Qualitative Disclosure About Market Risk	54
Item 8. Financial Statements and Supplementary Data	54
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	54
Item 9A. Controls and Procedures	54
Item 9B. Other Information	57
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	58
Item 11. Executive Compensation	58
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	58
Item 13. Certain Relationships and Related Transactions, and Director Independence	58
Item 14. Principal Accounting Fees and Services	58
PART IV	
Item 15. Exhibits, Financial Statement Schedules	59
Item 16. Form 10-K Summary	61
Signatures	

Cautionary Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K (this "Annual Report") contains forward-looking statements based on our current expectations, estimates and assumptions about future events. All statements other than statements of current or historical fact contained in this report, including statements regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of management for future operations, are forward-looking statements. The words "projections," "believe," "continue," "drive," "estimate," "expect," "intend," "may," "plan," "will," "could," "would" and similar expressions are generally intended to identify forward-looking statements.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We believe that these risks and uncertainties include, but are not limited to, those described in the "Risk Factors" section of this Annual Report, which include but are not limited to the following:

- the social and economic impact of the COVID-19 outbreak on our business;
- the impact of future legislation and other health care regulatory reform actions, and the effect of that legislation and other regulatory actions on our business;
- our ability to comply with current health care laws and regulations;
- reductions in payments from government health care programs and private insurance payors, such as health maintenance organizations ("HMOs"), preferred provider organizations ("PPOs"), and other managed care organizations and employers;
- our ability to contract with private insurance payors;
- changes in our payor mix or surgical case mix;
- failure to maintain or develop relationships with physicians on beneficial or favorable terms, or at all;
- the impact of payor controls designed to reduce the number of surgical procedures;
- our efforts to integrate operations of acquired businesses and surgical facilities, attract new physician partners, or acquire additional surgical facilities;
- shortages or quality control issues with surgery-related products, equipment and medical supplies;
- competition for physicians, nurses, strategic relationships, acquisitions and managed care contracts;
- our ability to attract and retain qualified health care professionals;
- our ability to enforce non-compete restrictions against our physicians;
- our ability to manage material liabilities whether known or unknown incurred as a result of acquiring surgical facilities;
- economic and competitive conditions;
- the outcome of legal and regulatory proceedings that have been or may be brought against us;
- changes in the regulatory, economic and other conditions of the states where our surgical facilities are located;
- payments we are required to make under the tax receivable agreement; and
- our indebtedness.

Although we base these forward-looking statements on assumptions that we believe are reasonable when made, we caution you that our actual results of operations, financial condition and liquidity, and the development of the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this Annual Report. We have based these forward-looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. They can be affected by known or unknown risks, uncertainties and assumptions, including, among other things, the risks, uncertainties and assumptions described in Item 1A. "Risk Factors."

Any forward-looking statements and other information set forth in this Annual Report speak only as of the date made. Other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, press releases, investor presentations and our website.

PART I

Item 1. Business

Overview

Surgery Partners, Inc., a Delaware corporation, acting through its subsidiaries, owns and operates a national network of surgical facilities and ancillary services. Unless the context otherwise indicates, Surgery Partners, Inc. and its subsidiaries are referred to herein as "Surgery Partners," "we," "us," "our" or the "Company."

On August 31, 2017, (i) we completed the sale and issuance of 310,000 shares of our 10.00% Series A Convertible Perpetual Participating Preferred Stock (the "Series A Preferred Stock") to a fund advised by an affiliate of Bain Capital Private Equity LP ("Bain Capital"), at a cash purchase price of \$1,000 per share (the "Preferred Private Placement"), and (ii) Bain Capital completed its purchase of 26,455,651 shares (the "Purchased Shares") of our common stock (the "Private Sale"). As a result, Bain Capital became our controlling stockholder, holding Series A Preferred Stock and Common Stock that collectively represented approximately 65.7% of the voting power of all classes of capital stock of the Company as of August 31, 2017. We refer to the Preferred Private Placement and the Private Sale collectively in this Annual Report as the "Transactions."

As of December 31, 2020, we owned or operated primarily in partnership with physicians, a portfolio of 127 surgical facilities in the United States ("U.S.") comprised of 110 ambulatory surgical centers ("ASCs") and 17 surgical hospitals ("surgical hospitals," and together with ASCs referred to as "surgical facilities" or "facilities") across 30 states, including a majority interest in 84 of the surgical facilities. During 2020, patient services provided in our surgical facilities generated approximately \$1.8 billion in revenue.

Our Growth Strategies

Our differentiated operating model employs a multifaceted strategy to grow revenue, earnings and cash flow. We believe the following are key components to this strategy:

- Deliver outstanding patient care and clinical outcomes;
- Continue to execute and expand upon our physician engagement strategy in attractive markets;
- Become the partner of choice for physicians seeking to become or stay independent;
- Drive organic growth at existing facilities through targeted physician recruitment, service line expansion and implementing our efficient operating model;
- Seek partnership opportunities with payors to make health care more affordable for their members;
- Seek partnership opportunities with health systems looking to develop and/or enhance their ambulatory surgery footprint to better meet the needs of the patients and medical staff;
- Continue our disciplined acquisition strategy;
- Offer new services to provide a more comprehensive continuum of care; and
- Enhance operational efficiencies and productivity by delivering on integration.

In addition, we believe favorable industry trends such as an aging population and advancements in medical technology will further drive growth.

Total Addressable Market

Based on management estimates, we believe that the total U.S. surgical facility market represents approximately \$90 billion in annual revenue, including approximately \$55 billion of hospital outpatient department procedures and \$35 billion of ambulatory surgical center procedures, and we believe that ambulatory surgical centers are capturing an increasing share of the total surgical procedure market. We estimate that as a result of this trend, total annual procedure volume is expected to grow over the next few years by approximately 2% in hospital outpatient departments and by approximately 6% in ambulatory surgery centers, while inpatient procedures will decline by approximately 2% during the same period. In addition, we believe that approximately \$60 billion of inpatient surgical cases have the potential to move to outpatient surgery centers, which, together with procedures performed at hospital outpatient departments and ambulatory surgical centers, represents what we believe is a total addressable market of approximately \$150 billion.

Patient and Physician Satisfaction

We are leveraging our growth strategies to capture market share by providing high quality service. According to a 2019 survey of health and life safety tags, our ASCs averaged 25% fewer deficiencies compared with the total market, with 6.3 deficiencies at our ASCs compared to 8.4 in other ASCs. Similarly, our surgical hospitals averaged 48% fewer deficiencies per survey compared to all other hospitals surveyed, with 17.6 deficiencies for our surgical hospitals compared with 33.7 deficiencies at other hospitals according to a 2019 industry survey. In addition, 71% of our surgical hospitals in 2019 were rated five star in the CMS star rating, with the remaining 29% rated four star. This has resulted in an average patient net promoter score of 94, based on patient satisfaction surveys conducted from December

2019 to May 2020. Our physicians similarly report strong satisfaction levels with Surgery Partners, with an average physician net promoter score of 81 based on a 2015 survey.

Impact of COVID-19 update

The COVID-19 global pandemic has significantly affected our facilities, employees, patients, communities, business operations and financial performance, as well as the U.S. economy and financial markets. Beginning mid-March 2020, the COVID-19 pandemic began to negatively affect our revenue and business operations, due in part to local, state and federal guidelines, as well as recommendations from major medical societies, requiring social distancing and self-quarantines in response to the COVID-19 pandemic. Surgical case volumes across most of our surgical facilities were significantly impacted in the second quarter of 2020. The impact of COVID-19 on our surgical facilities has varied based on the market in which the facility operates, the type of surgical facility and the procedures typically performed. Although we cannot provide any certainty regarding the length and severity of the impact of the COVID-19 pandemic, surgical case volumes improved in the second half of 2020 as states began to re-open and allow for non-emergent procedures.

Our operating structure naturally enables some flexibility in the cost structure according to the volume of surgical procedures performed, including much of our cost of revenues. In addition to the natural variability of these costs, we and our partners in the surgical facilities have undertaken additional steps to preserve financial flexibility. Beginning in mid-March, and during the remainder of 2020, we took actions that included significantly reducing cash operating expenses and deferring non-essential expenditures at the height of the crisis. These measures were gradually reduced as surgical case volumes improved. For more information, please refer to Note 1. "Organization and Summary of Accounting Policies - COVID-19 Pandemic" to our audited consolidated financial statements for the year ended December 31, 2020 included elsewhere herein.

Operations

During 2020, we operated in three reporting segments: Surgical Facility Services, Ancillary Services and Optical Services.

- Our Surgical Facility Services segment consisted of the operation of ASCs and surgical hospitals and includes our anesthesia services. Our surgical facilities primarily provide non-emergency surgical procedures across many specialties, including, among others, orthopedics and pain management, ophthalmology, gastroenterology ("GI") and general surgery.
- Our Ancillary Services segment consisted of a diagnostic laboratory and multi-specialty physician practices, including physician practices owned and operated pursuant to long-term management service agreements. During the third quarter of 2020, we closed our diagnostic laboratory.
- Our Optical Services segment consisted of an optical products group purchasing organization, which was divested on December 31, 2020. Until we divested certain businesses in October 2018, this segment also included an optical laboratory that manufactured eyewear. Our Optical Services segment was not a material component of our total revenue, contributing less than 1% in each of 2020, 2019 and 2018.

Surgical Facility Services Segment

Surgical Facility Operations

As of December 31, 2020, we owned or operated primarily in partnership with physicians, 127 surgical facilities, including 110 ASCs and 17 licensed surgical hospitals. Our Surgical Facility Services segment contributed approximately 96% of our total revenue in 2020, and 95% of our total revenue in both 2019 and 2018.

Our typical ASC is a free-standing facility that performs planned surgical procedures on an outpatient basis for patients not requiring hospitalization and for whom an overnight stay is not expected after surgery. Each center typically has one to four operating or procedure rooms with areas for reception, pre-operative care, recovery and administration. The staff of our ASCs generally includes a center administrator, registered nurses, operating room technicians, as well as other administrative staff.

Our surgical hospitals are generally larger than our ASCs and include inpatient hospital rooms and, in certain cases, emergency departments. Our surgical hospitals also provide services such as diagnostic imaging, laboratory, obstetrics, oncology, pharmacy, physical therapy and wound care.

We operate both multi-specialty and single-specialty facilities. In multi-specialty facilities, a variety of surgical procedures are performed, including, among others, orthopedics and pain management, ophthalmology, GI and general surgery. We have diversified the mix of procedures performed at our facilities by strategically introducing select specialties that will complement existing services. In many cases, we keep certain facilities as single-specialty where it suits an individual facility or market demand.

Our surgical facilities are generally located in close proximity to physicians' offices. We provide each of our surgical facilities with a full range of financial, marketing and operating services. For example, our regional managed care directors assist the local management team at each of our surgical facilities in developing relationships with private insurance payors and negotiating private insurance contracts.

Surgical Facility Ownership Structure

We own and operate our surgical facilities through partnerships or limited liability companies with physicians, physician groups and health care systems. One of our wholly-owned subsidiaries typically serves as the general partner or managing member of our surgical

facilities. We generally seek to own a majority interest in our surgical facilities or otherwise have sufficient control over the facilities in order to consolidate the financial results. In some instances, we will acquire ownership in a surgical facility with the prior owners retaining ownership, and, in some cases, we offer new ownership to other physicians or health care systems. We hold majority ownership in 84 of the 127 surgical facilities in which we own an interest. We provide intercompany loans to some of the surgical facilities which often are secured by a pledge of assets of the facility. We also provide day-to-day management services for a majority of our surgical facilities pursuant to a management agreement and receive a management fee that is typically equal to a percentage of the facility revenue.

Strategic Relationships

When attractive opportunities arise, we may develop, acquire or operate surgical facilities through strategic relationships with payors, health care systems, and other health care providers. We believe that forming such strategic relationships can enhance our ability to attract physicians and access favorable private insurance contracts for our surgical facilities in that market.

The strategic relationships through which we own and operate surgical facilities are governed by partnership and operating agreements that are generally comparable to the partnership and operating agreements of the other surgical facilities in which we own an interest. The primary difference between the structure of these strategic relationships and the other surgical facilities in which we hold ownership is that, in these strategic relationships, a health care system holds ownership in the surgical facility in addition to physician investors. In each of these strategic relationships, we also have entered into a management agreement under which we provide day-to-day management services for a management fee equal to a percentage of the revenues of the surgical facility. The terms of those management agreements are comparable to the terms of our management agreements with other surgical facilities in which we own an interest.

Sources of Revenue

Revenue from our surgical facilities is earned from facility fees related to health care services performed in our surgical facilities and is included in our patient service revenues. The fee charged for surgical services varies depending on the type of service provided, but usually includes all charges for usage of an operating room, a recovery room, special equipment, supplies, nursing staff and/or medications. Our fees do not typically include professional fees charged by the patient's surgeon, anesthesiologist or other attending physician, which are billed directly by such physicians.

We are dependent upon government and private insurance sources of payment for the services we provide. The amounts that our surgical facilities receive in payment for their services may be adversely affected by market and cost factors as well as other factors over which we have no control, including Medicare, Medicaid and state regulations, cost containment and utilization decisions and reduced reimbursement schedules of private insurance payors.

The following table sets forth the percentage of total patient service revenues for our consolidated surgical facilities by type of payor for the periods indicated:

	Year Ended December 31,		
	2020	2019	2018
Private Insurance	53.9 %	53.8 %	54.6 %
Government	38.6 %	38.9 %	37.6 %
Self-pay	3.2 %	2.6 %	2.9 %
Other	4.3 %	4.7 %	4.9 %
Total patient service revenues	100.0 %	100.0 %	100.0 %

We receive reimbursement from Medicare for surgical services based on three different payment systems depending on the site of service: hospital inpatient surgical services, hospital outpatient surgical services and outpatient surgical services generally provided in our ASCs.

Medicare Reimbursement - Hospital Inpatient Services

Seventeen of our surgical facilities are licensed as hospitals. Most inpatient services provided by hospitals are reimbursed by Medicare under the inpatient prospective payment system ("IPPS"). Under the IPPS, a hospital receives a fixed amount for inpatient hospital services based on each patient's final assigned Medicare-severity diagnosis related group ("MS-DRG"). Each MS-DRG is assigned a payment rate that is prospectively set by the Centers for Medicare and Medicaid Services ("CMS") using national average resources used per case for treating a patient with a particular diagnosis. This assignment also affects the prospectively determined capital rate paid with each MS-DRG. MS-DRG and capital payments are adjusted by a predetermined geographic adjustment factor assigned to the geographic area in which the hospital is located. The index used to adjust the MS-DRG rates, known as the "hospital market basket index," gives consideration to the inflation experienced by hospitals in purchasing goods and services.

On September 2, 2020, CMS published the IPPS final rule for federal fiscal year ("FFY") 2020, which began on October 2, 2020. Under the FFY 2020 final rule, rates for inpatient stays in hospitals paid under the IPPS that successfully report certain quality data under the Hospital Inpatient Quality Reporting ("IQR") Program and demonstrate meaningful use of certified electronic health record ("EHR") technology will be increased by 2.9%. Those hospitals that do not successfully report quality data under the IQR Program (but are

meaningful EHR users) may receive a payment rate increase of only 1.85%. In addition to the IQR Program, hospitals will be subject to payment adjustments under the Value Based Purchasing Program, Readmissions Reduction Program and Hospital Acquired Conditions Reduction Programs that have been implemented by the Department of Health and Human Services ("HHS").

Medicare Reimbursement - Hospital Outpatient Departments

Surgical services that are provided in hospital outpatient departments ("HOPDs") generally are reimbursed by CMS using the Outpatient Prospective Payment System (the "OPPS"). The OPPS, established by the Secretary of HHS, determines payment amounts prospectively (generally the following calendar year) for various categories of medical services performed in HOPDs. On December 2, 2020, CMS published its OPPS final rule for 2021. The final rule provides for a payment rate increase of 2.4%. Hospitals that do not meet the reporting requirements of the Medicare Hospital Outpatient Quality Reporting Program will be subject to a 2.0% payment rate decrease.

Additionally, as a result of legislative changes related to off-campus HOPDs, certain off-campus HOPDs that began billing under the OPPS (or underwent certain changes) on or after November 2, 2015 are no longer paid for most services under the OPPS. Instead, these facilities are paid under the Medicare Physician Fee Schedule ("MPFS"), which typically results in lower reimbursements. Services provided in a dedicated emergency department are still paid under the OPPS. This change has not significantly affected reimbursement to any of our HOPDs, but we cannot assure you that our HOPDs will not be impacted in the future.

Medicare Reimbursement - ASCs

Payments under the Medicare program to ASCs are also made based on the OPPS. However, the payment received from CMS is a percentage of the payment to HOPDs. Reimbursement rates for ASCs are updated annually based on changes in the consumer price index offset by multifactor productivity adjustments. Based on the OPPS Final Rule, ASC reimbursement rates will increase by 2.4% for 2021. CMS has established the Ambulatory Surgical Center for Quality Reporting ("ASCQR") Program as a pay-for-reporting, quality data program. Our ASCs that participate in the ASCQR Program receive the full annual update to the ASC payment rate. Those ASCs that do not successfully report quality data under the ASCQR Program may receive a payment reduction.

Annual Cost Reports

Hospitals participating in Medicare and Medicaid programs, whether paid on a reasonable cost basis or under a prospective payment system, may be required to meet certain financial reporting requirements. Federal and, where applicable, state regulations require submission of annual cost reports identifying medical costs and expenses associated with the services provided by each hospital to Medicare beneficiaries and Medicaid recipients. Annual cost reports required under the Medicare and Medicaid programs are subject to routine governmental audits. These audits may result in adjustments to the amounts ultimately determined to be payable to us under these reimbursement programs. Finalization of these audits often takes several years. Providers may appeal any final determination made in connection with an audit. While ASCs are not currently subject to federal cost reporting requirements, it is possible that such requirements, which could be costly for us, will be implemented by CMS in the future.

Ancillary Services Segment

Ancillary Services

Our portfolio of outpatient surgical facilities is complemented by a suite of ancillary services, which support our physicians in providing high quality and cost-efficient patient care. Our ancillary services are comprised of multi-specialty physician practices, urgent care facilities and anesthesia services. The Company, physicians and patients benefit from these services through improved clinical efficiency and scheduling, and from incremental revenue associated with retaining fees for these services. Our Ancillary Services segment contributed approximately 3% of our total revenue in 2020, and 4% of our total revenue in both 2019 and 2018.

- Until it was closed in the third quarter of 2020, we offered physicians toxicology testing services through our wholly-owned diagnostic laboratory based in Tampa, Florida.
- We employ two models in connection with our network of multi-specialty physician practices. For example, in the state of Florida, where the law does not preclude a business corporation from employing physicians, we wholly-own and operate physician practices in several locations throughout Florida. In certain other states, we operate physician practices pursuant to long-term management service agreements with separate professional corporations that are wholly-owned by physicians.

Sources of Revenue - Ancillary Services Segment

The fees charged for services in our Ancillary Services segment depend on a variety of factors, including the type of service provided, the location in which the service is provided and the provider of the service. Service fees are received from both government and private insurance payors. The amounts that we receive in payment for the provision of ancillary services may be adversely affected by market and cost factors as well as other factors over which we have no control, including Medicare, Medicaid and state regulations, cost containment and utilization decisions and reduced reimbursement schedules of private insurance payors.

Acquisition and Development Programs

Acquisition Program. In addition to our corporate strategy, we continuously evaluate opportunities to expand our presence in the surgical facility market by making strategic acquisitions of existing surgical facilities and by developing new surgical facilities in cooperation with local physician partners and, when appropriate, health care systems and other strategic partners. We generally structure

our partnerships as two-way arrangements where either we are a majority owner partnered with physicians or we are a minority owner with buy-up rights. These buy-up rights give us the option to own a controlling interest at some point in the future. Alternatively, we may choose to pursue a strategic relationship with physicians and a health care system.

We employ a dedicated acquisition team with experience in health care services. Our team seeks to acquire surgical facilities that meet our criteria, including prominence and quality of physician partners, specialty mix, opportunities for growth, level of competition in the local market, level of private insurance penetration and our ability to access private insurance contracts. We carefully evaluate each of our acquisition opportunities through an extensive due diligence process to determine which facilities have the greatest potential for growth and profitability improvements under our operating structure. Our team may also identify opportunities to attract additional physicians to increase the acquired facility's revenues and profitability.

Development Program. We develop surgical facilities in markets that we identify as having substantial interest by physicians and payors. We have experience in developing both single and multi-specialty surgical facilities. When we develop a new surgical facility, we generally provide all of the services necessary to complete the project. We offer in-house capabilities for structuring partnerships and financing facilities and work with architects and construction firms in the design and development of surgical facilities. Before and during the development phase of a new surgical facility, we analyze the competitive environment in the local market, review market data to identify appropriate services to provide, prepare and analyze financial forecasts, evaluate regulatory and licensing issues and assist in designing the surgical facility and identifying appropriate equipment to purchase or lease. After a surgical facility is developed, we typically provide general startup operational support, including information systems, equipment procurement and financing.

Marketing

We primarily direct our sales and marketing efforts at physicians who would utilize our surgical facilities. Marketing activities directed at physicians and other health care providers are coordinated locally by the individual surgical facility and are supplemented by dedicated corporate personnel. These activities generally emphasize the benefits offered by our surgical facilities compared to other facilities in the market, such as the proximity of our surgical facilities to physicians' offices, the ability to schedule consecutive cases without preemption by inpatient or emergency procedures, the efficient turnaround time between cases, our advanced surgical equipment and our simplified administrative procedures. Although the facility administrator is the primary point of contact, physicians who utilize our surgical facilities are important sources of recommendations to other physicians regarding the benefits of using our surgical facilities. Recruiting teams develop a target list of physicians, and we continually review our progress in successfully recruiting additional local physicians.

We also market our surgical facilities directly to private insurance payors. Payor marketing activities conducted by our corporate office management and facility administrators emphasize the high quality of care, cost advantages and convenience of our surgical facilities, and are focused on making each surgical facility an approved provider under local managed care plans.

Competition

In each market in which we operate a surgical facility, we compete with hospitals and operators of other surgical facilities to attract physicians and patients. We believe that the competitive factors that affect our surgical facilities' ability to compete for physicians are convenience of location of the surgical facilities, quality of care offered, convenience of scheduling, professionalism and cleanliness of facilities, access to capital and participation in private insurance programs. In addition, we believe the national prominence, scale and reputation of our company are instrumental in attracting physicians. We believe that our surgical facilities attract patients based upon our quality of care, the specialties and reputations of the physicians who operate in our surgical facilities, participation in managed care programs, ease of access and convenient scheduling and registration procedures.

In developing or acquiring existing surgical facilities, we compete with other public and private surgical facility and hospital companies. Several large national companies own and/or manage surgical facilities, in some cases in connection with other lines of business with which we do not compete, including HCA Holdings, Inc., Envision Healthcare Corporation, Tenet Healthcare Corporation, Surgical Care Affiliates, Inc. and Optum, Inc. We also face competition from local hospitals, physicians and other providers who may compete with us in the ownership and operation of surgical facilities, as well as the trend of physicians choosing to perform procedures in an office-based setting rather than in a surgical facility.

Seasonality

Our revenue fluctuates based on the number of business days in each calendar quarter, because the majority of services provided by physicians in our surgical facilities consist of scheduled procedures and office visits that occur during business hours. In addition, revenue in the fourth quarter could also be impacted by an increased utilization of services due to annual deductibles which are not usually met until later in the year and also as patients utilize their health care benefits before they expire at year-end.

Human Capital Resources

At December 31, 2020, we had approximately 10,800 employees, including approximately 1,700 part-time employees. None of our employees are represented by a collective bargaining agreement. We believe that we have a good relationship with our employees. We are subject to various state and federal laws that regulate wages, hours, benefits and other terms and conditions relating to employment. In some markets, nurse and medical support personnel availability has become a significant operating issue to healthcare providers. To

address this challenge, we have implemented several initiatives to improve engagement, retention, recruiting, compensation programs and productivity.

Our surgical facilities are staffed by licensed physicians. Our mission is to enhance patient quality of life through partnership. We generally do not enter into contracts with physicians who use our surgical facilities, other than partnership and operating agreements with physicians who own interests in our surgical facilities, agreements for anesthesiology services and medical director agreements. Most physicians are not employees of our surgical facilities and are not contractually required to use our facilities. Physicians who use our surgical facilities also use other facilities or hospitals and may choose to perform procedures in an office-based setting that might otherwise be performed at our surgical facilities. Our operations are dependent on the efforts, abilities and experience of our physicians and clinical personnel. We compete with other health care providers, primarily hospitals and other surgical facilities, in attracting physicians to utilize our surgical facilities, nurses and medical staff to support our surgical facilities, recruiting and retaining qualified management and support personnel responsible for the daily operations of each of our facilities.

Our surgical facilities, like most healthcare providers, have experienced rising labor costs. We may be required to continue to enhance wages and benefits to recruit and retain nurses and other medical support personnel or to hire more expensive temporary or contract personnel. As a result, our labor costs could continue to increase. We also depend on the available labor pool of semi-skilled and unskilled employees in each of the markets in which we operate.

We believe that our employees are vital contributors to our success, and we devote significant resources to recruit and retain our workforce. We strive to recruit and retain a diverse population of employees at all stages of their careers that are reflective of the communities we serve. We are committed to promoting an inclusive culture through diversity of thoughts and backgrounds, recognizing the value these experiences bring to our colleagues, physicians, patients and the communities in which we reside. Our workforce is comprised of approximately 81% female and 26% people of color. Our policies prohibit discrimination on the basis of race, sex, religion, color, national or ethnic origin, age, disability, sexual orientation, gender identity, gender expression, military service, pregnancy, physical or mental disabilities, genetic information, or any other class protected by applicable law in its administration of policies, programs or employment.

We have established, and continue to enhance and refine, a comprehensive set of practices for engagement, recruiting, managing and optimizing the human resources of our organization. In general, we seek to attract, develop and retain an engaged workforce and improve talent management processes accordingly. We offer a competitive range of compensation and benefit programs. In response to the COVID-19 pandemic, we implemented changes to address the safety and interests of our patients, employees, and medical staff, including the implementation of additional safety measures. Our code of conduct that promotes integrity, accountability and transparency, among other high ethical standards and a focus on employee welfare.

Environmental

We are subject to various federal, state and local laws and regulations relating to the protection of the environment and human health and safety, including those governing the management and disposal of hazardous substances and wastes, the cleanup of contaminated sites and the maintenance of a safe workplace. Our operations include the use, generation and disposal of hazardous materials. We may, in the future, incur liability under environmental statutes and regulations with respect to contamination of sites we own or operate (including contamination caused by prior owners or operators of such sites, adjoining properties or other persons) and the off-site disposal of hazardous substances. We believe that we have been and are in substantial compliance with the terms of all applicable environmental laws and regulations and that we have no liabilities under environmental requirements that we would expect to have a material adverse effect on our business, results of operations or financial condition (including our capital expenditures, earnings and competitive position).

Insurance

We maintain liability insurance in amounts that we believe are appropriate for our operations. Currently, we maintain professional, general and workers' compensation liability insurance in excess of self-insured retentions through third party commercial insurance carriers. We also maintain cyber insurance, business interruption insurance and property damage insurance. Coverage under certain of these policies is contingent upon the policy being in effect when a claim is made regardless of when the events which caused the claim occurred.

In addition, physicians who provide professional services in our surgical facilities are required to maintain separate malpractice coverage with defined minimum coverage limits. While we believe that our insurance policies are adequate in amount and coverage for our operations, we make no assurances that the insurance coverage is sufficient to cover all future claims or will continue to be available in adequate amounts or at a reasonable cost.

Private Insurance Payors

Most private third-party payors reimburse us for services pursuant to written contracts. These contracts generally require that we offer discounts from our established charges. Some of our payments come from private insurance payors with which we do not have written contracts. In those situations, commonly known as "out-of-network" services, we generally charge the patients the same co-payment or other patient responsibility amounts that we would have charged had we had a contract with the private insurance payor. We also submit a claim for the services to the private insurance payor along with full disclosure that we have charged the patient an in-network patient responsibility amount.

Governmental Regulation

General

Our businesses are subject to federal, state and local laws dealing with issues such as occupational safety, employment, medical leave, insurance regulations, civil rights, discrimination, building codes and medical waste and other environmental issues. Federal, state and local governments are expanding the regulatory requirements on businesses like ours. The imposition of these regulatory requirements may have the effect of increasing operating costs and reducing the profitability of our operations.

Regulatory Development in Response to COVID-19

Numerous recent legislative and regulatory actions have been taken in an attempt to provide businesses, including health care providers, with relief from the negative impacts of the COVID-19 pandemic. The legislative and regulatory responses to the COVID-19 pandemic generally impact many of the statutes, regulations and policies summarized or discussed throughout this Annual Report.

CARES Act and Other Stimulus Legislation

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law to provide stimulus funding for the U.S. economy. The CARES Act is intended to provide over \$2 trillion in stimulus benefits for the U.S. economy in order to offset the negative economic impact of the COVID-19 public health emergency. Among other things, the CARES Act includes support for small businesses, expands unemployment benefits, and provides \$500 billion for loans, loan guarantees, and other investments for or in U.S. businesses.

The CARES Act contains a number of provisions that are intended to assist health care providers as they combat the effects of the COVID-19 public health emergency. The healthcare-specific provisions include:

- the temporary suspension of Medicare sequestration from May 1, 2020, to March 31, 2021;
- an appropriation of \$100 billion to the Public Health and Social Services Emergency Fund for a new program to reimburse, through grants or other mechanisms, eligible health care providers and other approved entities for COVID-19-related expenses or lost revenues;
- the expansion of CMS' Accelerated and Advance Payment Program; and
- waivers or temporary suspension of certain regulatory requirements.

On December 27, 2020, the COVID-19 Economic Relief Bill (the "Bill") was enacted, which among other significant matters, revised previous guidance on how grant funds distributed under the CARES Act may be utilized. These changes included greater clarity on the measurement of lost revenues eligible to be claimed against grant funds received through the CARES Act as well as how funds can be allocated among consolidated facilities.

HHS' interpretation of the underlying terms and conditions of grant funds received through the CARES Act, the Bill and other governmental assistance programs, including auditing and reporting requirements, continues to evolve. Additional guidance or new and amended interpretations of existing guidance on the terms and conditions of such payments may result in our inability to recognize certain payments, changes in the estimate of amounts recognized, or the derecognition of amounts previously recognized, including the amount estimated and included in our consolidated statement of operations for the year ended December 31, 2020 provided herein. Such changes may be material.

We continue to closely monitor legislative actions and regulatory guidance at the federal, state and local levels with respect to the CARES Act as other governmental assistance might become available to us. For more information, please refer to Note 1. "Organization and Summary of Accounting Policies - COVID-19 Pandemic" to our audited consolidated financial statements for the year ended December 31, 2020 included elsewhere herein.

Waivers or Temporary Suspension of Certain Regulatory Requirements

In addition to the financial and other relief that has been provided by the federal government through the CARES Act and other legislation that has been passed by Congress, CMS and many state governments have also issued a number of waivers and temporary suspensions of health care facility licensure, certification, and reimbursement requirements in order to provide hospitals, ambulatory surgery centers, physicians, and other health care providers with increased flexibility to meet the challenges presented by the COVID-19 public health emergency. For example, CMS has temporarily waived the enforcement of certain requirements of the Medicare conditions of participation and implemented a "hospitals without walls" program that would enable hospitals to treat patients in temporary locations and enable ASCs to temporarily enroll in Medicare as hospitals. CMS has also temporarily waived many provisions of the Stark law, including those provisions of the Stark law that prohibit our hospitals with physician ownership from expanding capacity. Many states have also suspended the enforcement of certain regulatory requirements to ensure that health care providers have sufficient capacity to treat COVID-19 patients. These regulatory changes are temporary, and we anticipate substantially all requirements will be reinstated in all material respects at the conclusion of the public health emergency.

Certificates of Need, Licensure and Accreditation

Capital expenditures for the construction of new health care facilities, the addition of beds or new health care services or the acquisition of existing health care facilities may be reviewable by state regulators under statutory programs that are sometimes referred to as certificate of need laws. States with certificate of need laws place limits on the construction and acquisition of health care facilities and the expansion of existing facilities and services. In these states, approvals, generally known as certificates of need, are required for capital expenditures exceeding certain preset monetary thresholds for the development, acquisition and/or expansion of certain facilities or services, including, in certain of these states, surgical facilities. Certificate of need laws are being challenged in many states across the country and any future changes could have positive and negative impacts on our business. We currently operate in 20 states that have certificate of need laws.

Our surgical facilities also are subject to state licensing requirements for medical providers. Our ASCs have licenses to operate as required in the states in which they operate and must meet all applicable requirements for ASCs. In addition, even though our surgical facilities that are licensed as hospitals primarily provide surgical services, they must meet all applicable requirements for general hospital licensure. To assure continued compliance with these regulations, governmental and other authorities periodically inspect our surgical facilities. The failure to comply with these regulations could result in the suspension or revocation of a facility's license. In addition, based on the specific operations of our surgical facilities, some of these facilities maintain a pharmacy license, a controlled substance registration, a clinical laboratory certification waiver, and environmental protection permits for biohazards and/or radioactive materials, as required by applicable law.

As of December 31, 2020, the majority of our facilities were accredited by either The Joint Commission or the Accreditation Association for Ambulatory Health Care, two of the major national organizations that establish standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of various types of health care facilities. The effect of accreditation by these organizations is to exempt the facilities from routine surveys by state agencies to determine compliance with CMS requirements. These accredited facilities are subject to periodic surveys by the accrediting organization to ensure that they are in compliance with the applicable standards. Many private insurance health plans require our facilities to be accredited by one or both of these organizations in order to be participating providers. Failure to maintain accreditation would cause a facility to become subject to state survey agency oversight and potentially subject to increased scrutiny by CMS, and could result in a loss of payment from private insurance health plans.

Affordable Care Act Repeal Efforts

Initiatives to repeal or modify the Patient Protection and Affordable Care Act (the "Affordable Care Act") have been persistent over the past several years. As of December 31, 2020, legislative efforts to repeal and replace the Affordable Care Act in full have not been successful. However, as a result of the enactment of the Tax and Jobs Act of 2017, the tax penalty associated with the so-called "individual mandate," which requires most individuals to obtain qualifying health insurance coverage or pay a tax penalty, was reduced to zero starting in 2019. The effective repeal of the individual mandate tax penalty and any other future repeal or replacement of the Affordable Care Act may have significant impact on the reimbursement for health care services generally, and may cause more individuals to become uninsured, rendering them unable to afford our health care services. The Affordable Care Act also remains subject to various lawsuits challenging its enforcement and constitutionality. The U.S. Supreme Court recently agreed to hear a case that seeks to invalidate the Affordable Care Act, but it will not issue an opinion until 2021. Accordingly, there can be no assurance that the adoption of any future federal or state health care reform legislation, or any ruling by a court with respect to the Affordable Care Act, will not have a negative financial impact on the Company.

Medicare and Medicaid Private Contractor Audits

CMS has implemented a number of programs that use private contractors that contract with CMS to identify overpayments and underpayments and other potential sources of billing fraud. These contractors, known as Recovery Audit Contractors ("RACs") and Zone Program Integrity Contractors ("ZPICs") conduct both post-payment and pre-payment review of claims submitted by Medicare providers. In addition, CMS employs Medicaid Integrity Contractors ("MICs") to perform post-payment audits of Medicaid claims and identify overpayments. Our facilities and providers periodically receive letters from auditors such as RACs and ZPICs requesting repayment of alleged overpayments for services and incur expenses associated with responding to and appealing these determinations, as well as the costs of repaying any overpayments. Moreover, in recent years, the increase in Medicare payment appeals has created a backlog such that resolving appeals often takes multiple years.

Although all other repayments requested to date as a result of RAC, MIC and ZPIC audits have not been material to our Company, we are unable to quantify the aggregate financial impact of these audits on our facilities given the pending appeals and uncertainty about the extent of future audits.

Medicare and Medicaid Participation

The majority of our revenue is expected to continue to be received from third-party payors, including federal and state programs, such as Medicare and Medicaid, and private insurance payors. To participate in the Medicare program and receive Medicare payment, our surgical facilities must comply with regulations promulgated by HHS. Among other things, these regulations, known as "conditions for coverage" or "conditions of participation," impose numerous requirements on our facilities, their equipment, their personnel and their standards of medical care, as well as compliance with all applicable state and local laws and regulations. In 2007, CMS issued a policy memorandum (the "2007 CMS Policy Memorandum") that reaffirmed its prior interpretation of its conditions of participation that all

hospitals (other than critical access hospitals) participating in the Medicare program are required to provide basic emergency care interventions regardless of whether or not the hospital maintains an emergency department. Our facilities licensed as hospitals are required to meet this requirement to maintain their participating provider status in the Medicare program. Our hospitals that do not have an emergency room, maintain a protocol for the transfer of patients requiring emergency treatment. While we believe such protocols satisfy CMS requirements, CMS could interpret such protocols to be inconsistent with the 2007 CMS Policy Memorandum, which could jeopardize each facility's participation in the Medicare program. Our surgical facilities must also satisfy the conditions of participation to be eligible to participate in the various state Medicaid programs. The requirements for certification under Medicare and Medicaid are subject to change and, in order to remain qualified for these programs, we may have to make changes from time to time in our facilities, equipment, personnel or services. Although we intend to continue to participate in these reimbursement programs, we cannot ensure that our surgical facilities will continue to qualify for participation.

The Affordable Care Act and its associated regulations require a hospital to provide written disclosure of physician ownership interests to the hospital's patients and on the hospital's website and in any advertising, along with annual reports to the government detailing such interests. Additionally, hospitals that do not have 24/7 physician coverage are required to inform patients of this fact and receive signed acknowledgment from the patients of the disclosure. A hospital's provider agreement may be terminated if it fails to provide the required notices.

Utilization Review

Federal law contains numerous provisions designed to ensure that services rendered by hospitals to Medicare and Medicaid patients meet professionally recognized standards, are medically necessary and that claims for reimbursement are properly filed. These provisions include a requirement that a sampling of admissions of Medicare and Medicaid patients must be reviewed by quality improvement organizations, which review the appropriateness of patient admissions and discharges, the quality of care provided, the validity of MS-DRG classifications and the appropriateness of cases of extraordinary length of stay or cost. Quality improvement organizations may deny payment for services provided or assess fines and also have the authority to recommend to HHS that a provider which is in substantial noncompliance with the standards of the quality improvement organization be excluded from participation in the Medicare program. Utilization review is also a requirement of most non-governmental managed care organizations.

Federal Anti-Kickback Statute and Medicare Fraud and Abuse Laws

The Social Security Act of 1935 includes provisions addressing false statements, illegal remuneration and other instances of fraud and abuse in federal health care programs. These provisions include the statute commonly known as the federal Anti-Kickback statute (the "Anti-Kickback Statute"). The Anti-Kickback Statute prohibits providers and others from, among other things, soliciting, receiving, offering or paying, directly or indirectly, any remuneration in return for either making a referral for, or ordering or arranging for, or recommending the order of, any item or service covered by a federal health care program, including, but not limited to, the Medicare and Medicaid programs. Violations of the Anti-Kickback Statute are criminal offenses punishable by imprisonment and fines of up to \$25,000 for each violation. Civil violations are punishable by fines of up to \$50,000 for each violation, as well as damages of up to three times the total amount of remuneration received from the government for health care claims.

Because physician-owners of our surgical facilities are in a position to generate referrals to the facilities, the distribution of available cash to those investors could come under scrutiny under the Anti-Kickback Statute. Some courts have held that the Anti-Kickback Statute is violated if one purpose (as opposed to a primary or the sole purpose) of a payment to a provider is to induce referrals. Further, Section 6402(f)(2) of the Affordable Care Act amends the Anti-Kickback Statute by adding a provision to clarify that a person need not have actual knowledge of such section or specific intent to commit a violation of the Anti-Kickback Statute. Because none of these cases involved a joint venture such as those owning and operating our surgical facilities, it is not clear how a court would apply these holdings to our activities. It is clear, however, that a physician's investment income from a surgical facility may not vary with the number of his or her referrals to the surgical facility.

Under regulations issued by the Office of the Inspector General of HHS (the "OIG"), certain categories of activities are deemed not to violate the Anti-Kickback Statute (commonly referred to as the safe harbors). According to the preamble to these safe harbor regulations, the failure of a particular business arrangement to comply with the regulations does not determine whether the arrangement violates the Anti-Kickback Statute. The safe harbor regulations outline standards that, if complied with, protect conduct that might otherwise be deemed in violation of the Anti-Kickback Statute. When a transaction or relationship does not fit within a safe harbor, it does not mean that an Anti-Kickback Statute violation has occurred; rather, it means that the facts and circumstances as well as the intent of the parties related to a specific transaction or relationship must be examined to determine whether or not any illegal conduct has occurred.

We believe the ownership and operations of our surgical facilities do not fit wholly within any of the safe harbors, but we attempt to structure our ASCs to fit as closely as possible within the safe harbor designed to protect distributions to physician-investors in ASCs who directly refer patients to the ASC and personally perform the procedures at the center as an extension of their practice (the "ASC Safe Harbor"). The ASC Safe Harbor protects four categories of investors, including ASCs owned by (1) general surgeons, (2) single-specialty

physicians, (3) multi-specialty physicians and (4) hospital/physician joint ventures, provided that certain requirements are satisfied. These requirements include the following:

- The ASC must be certified to participate in the Medicare program, and its operating and recovery room space must be dedicated exclusively to the center and not a part of a hospital (although such space may be leased from a hospital if such lease meets the requirements of the safe harbor for space rental).
- Each investor must be either (a) a physician who derived at least one-third of his or her medical practice income for the previous fiscal year or 12-month period from performing procedures on the list of Medicare-covered procedures for ASCs, (b) a hospital, or (c) a person or entity not in a position to make or influence referrals to the center, nor to provide items or services to the center, nor employed by the center or any investor.
- Unless all physician-investors are members of a single specialty, each physician-investor must perform at least one-third of his or her procedures at the ASC each year. This requirement is in addition to the requirement that the physician-investor has derived at least one-third of his or her medical practice income for the past year from performing procedures.
- Physician-investors must have fully informed their referred patients of the physician's investment.
- The terms on which an investment interest is offered to an investor are not related to the previous or expected volume of referrals, services furnished or the amount of business otherwise generated from that investor to the entity.
- Neither the ASC nor any other investor nor any person acting on their behalf may loan funds to or guarantee a loan for an investor if the investor uses any part of such loan to obtain the investment interest.
- The amount of payment to an investor in return for the investment interest is directly proportional to the amount of the capital investment (including the fair market value of any pre-operational services rendered) of that investor.
- All physician-investors, any hospital-investor and the center agree to treat patients receiving benefits or assistance under a federal health care program in a non-discriminatory manner.
- All ancillary services performed at the ASC for beneficiaries of federal health care programs must be directly and integrally related to primary procedures performed at the center and may not be billed separately.
- No hospital-investor may include on its cost report or any claim for payment from a federal health care program any costs associated with the ASC.
- The ASC may not use equipment owned by or services provided by a hospital-investor unless such equipment is leased in accordance with a lease that complies with the Anti-Kickback Statute equipment rental safe harbor and such services are provided in accordance with a contract that complies with the Anti-Kickback Statute personal services and management contract safe harbor.
- No hospital-investor may be in a position to make or influence referrals directly or indirectly to any other investor or the center.

We believe that the ownership and operations of our surgical facilities will not fully satisfy the ASC Safe Harbor requirements for investment interests in ASCs because, among other things, we or one of our subsidiaries will generally be an investor in and provide management services to each ASC. While we believe our ASCs would nonetheless be found to be compliant with the Anti-Kickback Statute, we cannot assure you that the OIG would view our activities favorably even though we strive to achieve compliance with the remaining elements of this safe harbor.

In addition, although we expect each physician-investor to utilize the ASCs as an extension of his or her practice and ask each physician-investor to certify this practice, we cannot assure you that all physician-investors will derive at least one-third of their medical practice income from performing Medicare-covered ASC procedures, perform one-third of their procedures at the centers or inform their referred patients of their investment interests. Interests in our ASC joint ventures are purchased at what we believe to be fair market value. Investors who purchase at a later time generally pay more for a given percentage interest than founding investors. The result is that while all investors are paid distributions in accordance with their ownership interests, for ASCs where there are later purchases, we cannot meet the safe harbor requirement that return on investment is directly proportional to the amount of capital investment. The OIG has on several occasions reviewed investments relating to ASCs, and in Advisory Opinion No. 07-05 (June 19, 2007), raised concerns that (a) purchases of interests from physicians might yield gains on investment rather than capital infusion to the ASCs, (b) such purchases could be meant to reward or influence the selling physicians' referrals to the ASC or the hospital, and (c) such returns might not be directly proportional to the amount of capital invested.

In OIG Advisory Opinion No. 09-09 (July 29, 2009), the OIG concluded that an arrangement involving an ASC joint venture between a hospital and physicians involving the combination of their two ASCs into a single, larger ASC presented minimal risk of fraud or abuse, despite the fact that it did not fit within any applicable Anti-Kickback safe harbors. Additionally, the OIG stated that fair market value should be determined based only on the tangible assets of each ASC since the physician investors are referral sources for the ASC. The OIG stated that a cash flow-based valuation of the business contributed by the physician investors potentially would include the value of the physician investors' referrals over the time that their ASC was in existence prior to the merger with the hospital's ASC. The OIG went

on to note that a valuation involving intangible assets would not necessarily result in a violation of the Anti-Kickback Statute, but would require a review of all the facts and circumstances. It is not clear whether the OIG is concerned about using a cash flow-based valuation in most health care transactions involving referral sources, or just transactions where the parties' contributions would be valued differently for contributing the same assets if only one party's contribution is valued as a going concern based on cash flow. Also, the OIG appears to be focused on historical cash flow rather than a projected, discounted cash flow, which is a commonly used valuation methodology.

Our hospital investments do not fit wholly within the safe harbor for investments in small entities because more than 40.0% of the investment interests are held by investors who are either in a position to refer to the hospital or who provide services to the hospital and more than 40.0% of the hospital's gross revenue last year were derived from referrals generated by investors. However, we believe we comply with the remaining elements of the safe harbor.

In addition to the physician ownership in our surgical facilities, other financial relationships of ours with potential referral sources could potentially be scrutinized under the Anti-Kickback Statute. We have entered into management agreements to manage the majority of our surgical facilities and physician practices. Most of these agreements call for our subsidiary to be paid a percentage of revenue-based management fee. Although there is a safe harbor for personal services and management contracts (the "Personal Services and Management Safe Harbor"), the Personal Services and Management Safe Harbor requires, among other things, that the amount of the aggregate compensation paid to the manager over the term of the agreement be set in advance. Because our management fees are generally based on a percentage of revenue, our management agreements do not typically meet this requirement. We do, however, believe that our management arrangements satisfy the other requirements of the Personal Services and Management Safe Harbor for personal services and management contracts. The OIG has taken the position in several advisory opinions that percentage-based management agreements are not protected by a safe harbor, and consequently, may violate the Anti-Kickback Statute. We have implemented formal compliance programs designed to safeguard against overbilling and believe that our management agreements comply with the requirements of the Anti-Kickback Statute. However, we cannot assure you that the OIG would find our compliance programs to be adequate or that our management agreements would be found to comply with the Anti-Kickback Statute.

Certain of our ASCs have entered into arrangements for professional services, including arrangements for anesthesia services. In a Special Advisory Bulletin issued in April 2003, the OIG focused on "questionable" contractual arrangements where a health care provider in one line of business (the "Owner") expands into a related health care business by contracting with an existing provider of a related item or service (the "Manager/Supplier") to provide the new item or service to the Owner's existing patient population, including federal health care program patients (so called "suspect Contractual Joint Ventures"). The Manager/Supplier not only manages the new line of business, but may also supply it with inventory, employees, space, billing, and other services. In other words, the Owner contracts out substantially the entire operation of the related line of business to the Manager/Supplier-otherwise a potential competitor-receiving in return the profits of the business as remuneration for its referrals. Through an Advisory Opinion, the OIG extended this suspect contractual joint venture analysis to arrangements between anesthesiologists and physician owners of ASCs. In Advisory Opinion No. 12-06 (May 25, 2012), the OIG concluded that certain proposed arrangements between anesthesia groups and physician-owned ASCs could result in prohibited remuneration under the federal Anti-Kickback Statute. We believe our arrangements for anesthesia services are distinguishable from those described in Advisory Opinion 12-06 (May 25, 2012) and are in compliance with the requirements of the federal Anti-Kickback Statute. However, we cannot assure you that regulatory authorities would agree with that position.

We also may guarantee a surgical facility's third-party debt financing and certain lease obligations as part of our obligations under a management agreement. Physician investors are generally not required to enter into similar guarantees. The OIG might take the position that the failure of the physician investors to enter into similar guarantees represents a special benefit to the physician investors given to induce patient referrals and that such failure constitutes a violation of the Anti-Kickback Statute. We believe that the management fees (and in some cases guarantee fees) are adequate compensation to us for the credit risk associated with the guarantees and that the failure of the physician investors to enter into similar guarantees does not create a material risk of violating the Anti-Kickback Statute. However, the OIG has not issued any guidance in this regard.

The OIG is authorized to issue advisory opinions regarding the interpretation and applicability of the Anti-Kickback Statute, including whether an activity constitutes grounds for the imposition of civil or criminal sanctions. We have not, however, sought such an opinion regarding any of our arrangements. If it were determined that our activities, or those of our surgical facilities or hospitals, violate the Anti-Kickback Statute, we, our subsidiaries, our officers, our directors and each surgical facility and hospital investor could be subject, individually, to substantial monetary liability, prison sentences and/or exclusion from participation in any health care program funded in whole or in part by the U.S. government, including Medicare, Medicaid, TRICARE or state health care programs.

Evolving interpretations of current, or the adoption of new, federal or state laws or regulations, such as the Eliminating Kickbacks in Recovery Act (discussed below), could affect many of our arrangements. Law enforcement authorities, including the OIG, the courts and Congress, are increasing their scrutiny of arrangements between health care providers and potential referral sources to ensure that the arrangements are not designed as a mechanism to exchange remuneration for patient care referrals or opportunities. Investigators have also demonstrated a willingness to look behind the formalities of a business transaction to determine the underlying purposes of payments between health care providers and potential referral sources.

On November 20, 2020, CMS and the OIG issued final rules that modify the federal physician self-referral law, or Stark Law, regulations and the federal anti-kickback and civil monetary penalty for beneficiary inducement statutes and regulations. The intent of the final rules is to reduce over-burdensome and unnecessary regulatory barriers to value-based compensation models and accelerate the transformation of the health care system into one that better promotes the coordination of care among providers. Among other things, the

final rules create new anti-kickback and beneficiary inducement statute safe harbors and Stark Law exceptions for certain value based arrangements and arrangements that involve the donation of cybersecurity technology. In addition, the final rules provide additional guidance on several key compliance requirements, including fair market value and commercial reasonableness, that must be met in order for physicians and health care providers to comply with the Stark Law. We cannot yet predict the impact that the final rules will have on our surgery centers and hospitals.

Eliminating Kickbacks in Recovery Act

In addition to the Anti-Kickback Statute, the U.S. recently enacted a new law known as the Eliminating Kickbacks in Recovery Act (the "EKRA"). The EKRA is contained within the broader Substance Use Disorder Prevention that Promotes Opioid Recovery and Treatment for Patients and Communities Act (the "SUPPORT Act"). The EKRA creates a new federal crime for knowingly and willfully: (1) soliciting or receiving any remuneration in return for referring a patient to a recovery home, clinical treatment facility, or laboratory; or (2) paying or offering any remuneration to induce such a referral or in exchange for an individual using the services of a recovery home, clinical treatment facility, or laboratory. Each conviction under the EKRA is punishable by up to \$200,000 in monetary damages, imprisonment for up to ten (10) years, or both. Unlike the Anti-Kickback Statute, the EKRA is not limited to services reimbursable under a government health care program. While the SUPPORT Act targets substance abuse disorder prevention and recovery, the scope of EKRA is not limited to substance abuse drug testing (only one service line of a multitude provided by labs), and therefore it appears to prohibit payment for any patient referral to any laboratory for any service, unless an exception applies. While the EKRA does contain certain exceptions similar to the Anti-Kickback Statute Safe Harbors, those exceptions are more narrow than the Anti-Kickback Statute Safe Harbors.

Federal Physician Self-Referral Law

The Stark Law prohibits certain self-referrals for health care services. The Stark Law prohibits a practitioner, including a physician, dentist or podiatrist, from referring patients to an entity with which the practitioner or a member of his or her immediate family has a "financial relationship" for the provision of certain "designated health services" that are paid for in whole or in part by Medicare or Medicaid unless an exception applies. "Designated health services" include inpatient and outpatient hospital services, clinical laboratory services and radiology services. The term "financial relationship" is broadly defined and includes most types of ownership and compensation relationships. The Stark Law also prohibits the entity from seeking payment from Medicare or Medicaid for services that are rendered through a prohibited referral. If an entity is paid for services provided through a prohibited referral, it may be required to refund the payments. Violations of the Stark Law may also result in the imposition of damages equal to three times the amount improperly claimed and civil monetary penalties of up to \$15,000 per prohibited claim and \$100,000 per prohibited circumvention scheme and exclusion from participation in the Medicare and Medicaid programs.

Notably, "designated health services" does not include surgical services that are provided in an ASC. Furthermore, Stark Law regulations specifically define the term "designated health services" to not include services that are reimbursed by Medicare as part of a composite rate, such as services that are provided in an ASC. However, if designated health services are provided by an ASC and separately billed, referrals to the ASC by a physician-investor would be prohibited by the Stark Law. Because our facilities that are licensed as ASCs do not have independent laboratories and do not provide designated health services apart from surgical services, we do not believe referrals to these facilities by physician-investors are prohibited. If legislation or regulations are implemented that prohibit physicians from referring patients to surgical facilities in which the physician has a beneficial interest, our business and financial results could be materially adversely affected.

The Stark Law currently includes the Whole Hospital Exception, which applies to physician ownership of a hospital, provided such ownership is in the whole hospital and the physician is authorized to perform services at the hospital. We believe that physician investments in our facilities licensed as hospitals meet this requirement. However, certain changes to the Whole Hospital Exception were made by the Affordable Care Act including:

- a prohibition on hospitals from having any physician ownership unless the hospital already had physician ownership and a Medicare provider agreement in effect as of December 31, 2010;
- a limitation on the percentage of total physician ownership or investment interests in the hospital or entity whose assets include the hospital to the percentage of physician ownership or investment as of March 23, 2010;
- a prohibition from expanding the number of beds, operating rooms, and procedure rooms for which it is licensed after March 23, 2010, unless the hospital obtains an exception from the Secretary of the Department of Health & Human Services (the "Secretary");
- a requirement that return on investment be proportionate to the investment by each investor;
- restrictions on preferential treatment of physician versus non-physician investors;
- a requirement for written disclosures of physician ownership interests to the hospital's patients and on the hospital's website and in any advertising, along with annual reports to the government detailing such interests;
- a prohibition on the hospital or other investors from providing financing to physician investors;

- a requirement that any hospital that does not have 24/7 physician coverage inform patients of this fact and receive signed acknowledgments from the patients of the disclosure; and
- a prohibition on "grandfathered" status for any physician owned hospital that converted from an ASC to a hospital on or after March 23, 2010.

We cannot predict whether other proposed amendments to the Whole Hospital Exception will be included in any future legislation, including a repeal of the Affordable Care Act, or if Congress will adopt any similar provisions that would prohibit or otherwise restrict physicians from holding ownership interests in hospitals. Any such changes could have an adverse effect on our financial condition and results of operations.

In 2010, CMS issued a "self-referral disclosure protocol" for hospitals and other providers that wish to self-disclose potential violations of the Stark Law to CMS and to attempt to resolve those potential violations and any related overpayment liabilities at levels below the maximum penalties and amounts set forth in the statute.

In addition to the physician ownership in our surgical facilities, we have other financial relationships with potential referral sources that potentially could be scrutinized under the Stark Law. We have entered into personal service agreements, such as medical director agreements, with physicians at our surgical hospitals and physician owners within our physician practices may make referrals for certain designated health services within their physician practices. We believe that our agreements with referral sources satisfy the requirements of the personal service arrangements exception and that our physician practices satisfy the physician services and in-office ancillary services exceptions to the Stark Law and have implemented formal compliance programs designed to ensure continued compliance. However, we cannot assure you that the OIG or CMS would find our compliance programs to be adequate or that our agreements with referral sources would be found to comply with the Stark Law.

Other Fraud and Abuse Laws

The Medicare Patient and Program Protection Act of 1987, as amended by the Health Insurance Portability and Accountability Act of 1996, ("HIPAA"), and the Balanced Budget Act of 1997, impose civil monetary penalties and exclusion from state and federal health care programs on providers who commit violations of fraud and abuse laws. HIPAA authorizes the Secretary, and in some cases requires the Secretary, to exclude individuals and entities that the Secretary determines have "committed an act" in violation of applicable fraud and abuse laws or improperly filed claims in violation of such laws from participating in any federal health care program. HIPAA also expanded the Secretary's authority to exclude a person involved in fraudulent activity from participating in a program providing health benefits, whether directly or indirectly, in whole or in part, by the U.S. government. Additionally, under HIPAA, individuals who hold a direct or indirect ownership or controlling interest in an entity that is found to violate these laws may also be excluded from Medicare and Medicaid and other federal and state health care programs if the individual knew or should have known, or acted with deliberate ignorance or reckless disregard of, the truth or falsity of the information of the activity leading to the conviction or exclusion of the entity, or where the individual is an officer or managing employee of such entity. This standard does not require that specific intent to defraud be proven by OIG. Under HIPAA it is also a crime to defraud any commercial health care benefit program.

Federal and State Privacy and Security Requirements

We are subject to HIPAA, including the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"), which was enacted as part of The American Recovery and Reinvestment Act of 2009. The HITECH Act strengthened the requirements and significantly increased the penalties for violations of the HIPAA privacy and security regulations. In 2013, HHS issued the HIPAA Omnibus Rule, which became effective on March 26, 2013. The HIPAA Omnibus Rule requires us to notify patients of any unauthorized access, acquisition, or disclosure of their unsecured protected health information in all situations except those in which we can demonstrate that there is a low probability that the protected health information has been compromised. We have the burden of demonstrating through a risk assessment that a breach of protected health information has not occurred.

The HIPAA privacy standards apply to individually identifiable information held or disclosed by a covered entity in any form, whether communicated electronically, on paper or orally. These standards impose extensive administrative requirements on us. These standards require our compliance with rules governing the use and disclosure of this health information. They create rights for patients in their health information, such as the right to amend their health information, and they require us to impose these rules, by contract, on any business associate to whom we disclose such information in order to perform functions on our behalf.

The HIPAA security standards require us to establish and maintain reasonable and appropriate administrative, technical and physical safeguards to ensure the integrity, confidentiality and the availability of electronic protected health and related financial information. Although the security standards do not reference or advocate a specific technology, and covered health care providers, plans and clearinghouses have the flexibility to choose their own technical solutions, the security standards have required us to implement significant new systems, business procedures and training programs.

Violations of the HIPAA privacy and security regulations may result in civil and criminal penalties. The HITECH Act strengthened the requirements of the HIPAA privacy and security regulations and significantly increased the penalties for violations by introducing a tiered penalty system, with penalties of up to \$50,000 per violation with a maximum civil penalty of \$1.5 million in a calendar year for violations of the same requirement. However, a single breach incident can result in violations of multiple requirements, resulting in possible penalties well in excess of \$1.5 million. Under the HITECH Act, HHS is required to conduct periodic compliance audits of

covered entities and their business associates. The HITECH Act and the HIPAA Omnibus Rule also extend the application of certain provisions of the security and privacy regulations to business associates and subjects business associates to civil and criminal penalties for violation of the regulations.

The HITECH Act authorizes State Attorneys General to bring civil actions seeking either an injunction or damages in response to violations of HIPAA privacy and security regulations or the new data breach law that affects the privacy of their state residents. We expect vigorous enforcement of the HITECH Act's requirements by HHS and State Attorneys General. HHS has allocated increased funding towards HIPAA enforcement activity and such enforcement activity has seen a marked increase over recent years. We cannot predict whether our surgical facilities will be able to comply with the final rules and the financial impact to our surgical facilities in implementing the requirements under the final rules when they take effect, or whether our surgical hospitals will be selected for an audit, or the results of such an audit.

Our facilities also remain subject to any state laws that relate to privacy or the reporting of data breaches that are more restrictive than the regulations issued under HIPAA and the requirements of the HITECH Act. For example, various state laws and regulations may require us to notify affected individuals in the event of a data breach involving certain personal information, such as social security numbers, dates of birth and credit card information.

HIPAA Administrative Simplification Requirements

The HIPAA transaction regulations were issued to encourage electronic commerce in the health care industry. These regulations include standards that health care providers must follow when electronically transmitting certain health care transactions, such as health care claims.

Emergency Medical Treatment and Active Labor Act

Our hospitals are subject to the Emergency Medical Treatment and Active Labor Act ("EMTALA"). This federal law requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital's emergency department for treatment and, if the patient is suffering from an emergency medical condition, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions or transfer exists regardless of a patient's ability to pay for treatment. Off-campus facilities such as surgery centers that lack emergency departments or otherwise do not treat emergency medical conditions generally are not subject to EMTALA. They must, however, have policies in place that explain how the location should proceed in an emergency situation, such as transferring the patient to the closest hospital with an emergency department. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient's ability to pay, including civil monetary penalties and exclusion from participation in the government health care programs. In addition, an injured patient, the patient's family or a medical facility that suffers a financial loss as a direct result of another hospital's violation of the law can bring a civil suit against that other hospital. CMS has actively enforced EMTALA and has indicated that it will continue to do so in the future. We believe that our surgical hospitals comply with EMTALA.

State Regulation

Many of the states in which our surgical facilities operate have adopted statutes and/or regulations that prohibit the payment of kickbacks or any type of remuneration in exchange for patient referrals and that prohibit health care providers from, in certain circumstances, referring a patient to a health care facility in which the provider has an ownership or investment interest. While these statutes generally mirror the federal Anti-Kickback Statute and Stark Law, they vary widely in their scope and application. Some are specifically limited to health care services that are paid for in whole or in part by the Medicaid program; others apply to all health care services regardless of payor; and others apply only to state-defined designated services, which may differ from the designated health services under the Stark Law. In addition, many states have adopted statutes that mirror the False Claims Act and that prohibit the filing of a false or fraudulent claim with a state governmental agency. We intend to comply with all applicable state health care laws, rules and regulations. However, these laws, rules and regulations have typically been the subject of limited judicial and regulatory interpretation. As a result, we cannot assure you that our surgical facilities will not be investigated or scrutinized by the governmental authorities empowered to do so or, if challenged, that their activities would be found to be lawful. A determination of non-compliance with the applicable state health care laws, rules, and regulations could subject our surgical facilities to civil and criminal penalties and could have a material adverse effect on our operations.

We are also subject to various state insurance statutes and regulations that prohibit us from submitting inaccurate, incorrect or misleading claims. Many state insurance laws and regulations are broadly worded and could be implicated, for example, if our surgical facilities were to adjust an out-of-network co-payment or other patient responsibility amounts without fully disclosing the adjustment on the claim submitted to the payor. While some of our surgical facilities adjust the out-of-network costs of patient co-payment and deductible amounts to reflect in-network co-payment costs when providing services to patients whose health insurance is covered by a payor with which the surgical facilities are not contracted, our policy is to fully disclose adjustments in the claims submitted to the payors. We believe that our surgical facilities are in compliance with all applicable state insurance laws and regulations regarding the submission of claims. We cannot assure you, however, that none of our surgical facilities' insurance claims will ever be challenged. If we were found to be in violation of a state's insurance laws or regulations, we could be forced to discontinue the violative practice, which could have an adverse effect on our financial position and results of operations, and we could be subject to fines and criminal penalties.

Fee Splitting; Corporate Practice of Medicine

The laws of many states prohibit physicians from splitting fees with non-physicians (i.e., sharing in a percentage of professional fees), prohibit non-physician entities (such as us) from practicing medicine and exercising control over or employing physicians and prohibit referrals to facilities in which physicians have a financial interest. The existence, interpretation and enforcement of these laws vary significantly from state to state. In light of these restrictions, in certain states we facilitate the provision of physician services by maintaining long-term management services agreements through our subsidiaries with affiliated professional contractors, which employ or contract with physicians and other health care professionals to provide physician professional services. Under these arrangements, our subsidiaries perform only non-medical administrative services, do not represent that they offer medical services and do not exercise influence or control over the practice of medicine by the physicians employed by the affiliated professional contractors. Although we believe that the fees we receive from affiliated professional contractors have been structured in a manner that is compliant with applicable fee-splitting laws, it is possible that a government regulator could interpret such fee arrangements to be in violation of certain fee-splitting laws. Future interpretations of, or changes in, these laws might require structural and organizational modifications of our existing relationships, and we cannot assure you that we would be able to appropriately modify such relationships. In addition, statutes in some states could restrict our expansion into those states.

Clinical Laboratory Regulation

Our clinical laboratories are subject to federal oversight under the Clinical Laboratory Improvement Amendments of 1988 ("CLIA") which extends federal oversight to virtually all clinical laboratories by requiring that they be certified by the federal government or by a federally-approved accreditation agency. CLIA requires that all clinical laboratories meet quality assurance, quality control and personnel standards. Laboratories also must undergo proficiency testing and are subject to inspections. Standards for testing under CLIA are based on the complexity of the tests performed by the laboratory, with tests classified as "high complexity," "moderate complexity," or "waived." Laboratories performing high complexity testing are required to meet more stringent requirements than moderate complexity laboratories. Laboratories performing only waived tests, which are tests determined by the Food and Drug Administration to have a low potential for error and requiring little oversight, may apply for a certificate of waiver exempting them from most of the requirements of CLIA. Our operations also subject to state and local laboratory regulation. CLIA provides that a state may adopt laboratory regulations different from or more stringent than those under federal law, and a number of states have implemented their own laboratory regulatory requirements. State laws may require that laboratory personnel meet certain qualifications, specify certain quality controls, or require maintenance of certain records. We believe that we are in material compliance with all applicable laboratory requirements, but no assurances can be given that our laboratories will pass all future licensure or certification inspections.

Regulatory Compliance Program

We have in place and continue to enhance a company-wide compliance program that focuses on all areas of regulatory compliance including billing, reimbursement, cost reporting practices and contractual arrangements with referral sources.

This regulatory compliance program is intended to help ensure that high standards of conduct are maintained in the operation of our business and that policies and procedures are implemented so that employees act in compliance with applicable laws, regulations and company policies. Under the regulatory compliance program, every employee and certain contractors involved in patient care, and coding and billing, receive initial and periodic legal compliance and ethics training. In addition, we regularly monitor our ongoing compliance efforts and develop and implement policies and procedures designed to foster compliance with the law. The program also includes a mechanism for employees to report, without fear of retaliation, any suspected legal or ethical violations to their supervisors, designated compliance officers in our facilities, our compliance hotline or directly to our corporate compliance office. We believe our compliance program is consistent with standard industry practices. However, we cannot provide any assurances that our compliance program will detect all violations of law or protect against qui tam suits or government enforcement actions.

Where You Can Find More Information

We make available on or through the "Investors-SEC Filings" page of our website at www.surgerypartners.com, free of charge, copies of reports, such as Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to those reports (along with certain other Company filings with the SEC), as soon as reasonably practicable after electronically filing such material with, or furnishing it to, the SEC. The information found on, or otherwise accessible through, our website is not incorporated by reference into, nor does it form a part of, this Annual Report or any other document that we file with the SEC.

Item 1A. Risk Factors

Risk Factors Summary

Below is a summary of the principal factors that make an investment in our common stock speculative or risky. This summary does not address all of the risks that we face. Additional discussion of the risks summarized in this risk factor summary, and other risks that we face, can be found below under the heading “Risk Factors” and should be carefully considered, together with other information in this Annual Report and our other filings with the SEC, before making an investment decision regarding our common stock.

COVID-19 and Other Potential Pandemic Risks

- The COVID-19 global pandemic continues to significantly affect our operations, business and financial condition, and our liquidity could continue to be negatively impacted further if the U.S. economy remains unstable for a significant amount of time or it takes an extended period for patient volumes at our facilities to recover to pre-COVID-19 pandemic levels.

Business and Operational Risks

- We depend on payments from third-party payors, including government health care programs and private insurance organizations. If these payments are reduced or eliminated, our revenue and profitability could be materially and adversely affected.
- If we are unable to negotiate and enter into favorable contracts or maintain satisfactory relationships and renew existing contracts on favorable terms with private insurance payors, our revenue and profitability may decrease.
- Significant changes in our payor mix or surgical case mix resulting from fluctuations in the types of cases performed at our facilities could have a material adverse effect on our business, prospects, results of operations and financial condition.
- Our ability to provide medical services at our facilities would be impaired and our revenue reduced if we are not able to maintain good relationships with affiliated physicians who utilize our surgical facilities.
- Physician treatment methodologies and governmental or private insurance controls designed to reduce the number of surgical procedures may reduce our revenue and profitability.
- Our growth strategy depends in part on our ability to integrate operations of acquired surgical facilities, attract new physician partners, and to acquire and develop additional surgical facilities on favorable terms. If we are unable to achieve any of these goals, our future growth could be limited and our operating results could be adversely affected.
- Shortages of surgery-related products, equipment and medical supplies and quality control issues with such products, equipment and medical supplies could disrupt our operations and adversely affect our case volume, surgical case mix and profitability.
- We face competition from other health care facilities and providers.
- Competition for physicians and clinical personnel, including nurses, shortages of qualified personnel or other factors could increase our labor costs and adversely affect our revenue, profitability and cash flows.
- If any of our existing health care facilities lose their accreditation status or any of our new facilities fail to receive accreditation, such facilities could become ineligible to receive reimbursement under Medicare or Medicaid or other third-party payors.
- Growth of patient receivables or deterioration in the ability to collect on these accounts, due to changes in economic conditions or otherwise, could have a material adverse effect on our business, prospects, results of operations and financial condition.
- If we are unable to integrate and operate our information systems effectively or implement new systems and processes, our operations could be disrupted.

Financial and Accounting Risks

- We have a history of net losses and may not achieve or sustain profitability in the future.
- Our leverage could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our variable rate debt and prevent us from meeting our obligations under our outstanding indebtedness.
- To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control, and any failure to meet our debt service obligations may adversely affect our business, financial condition and results of operations.
- Despite our current indebtedness levels, we and our subsidiaries may still be able to incur more debt, which could further exacerbate the risks associated with our leverage.
- We make significant loans to, and are generally liable for debts and other obligations of, the partnerships and limited liability companies that own and operate some of our surgical facilities.

- We may be limited in our ability to utilize, or may not be able to utilize, net operating loss carryforwards to reduce our future tax liability.
- We entered into a tax receivable agreement that will require us to make payments to the pre-IPO owners of Surgery Center Holdings, LLC (the "Pre-IPO Owners"), which amounts are expected to be material.

Cybersecurity and Data Risks

- Cybersecurity attacks or intrusions could adversely impact our businesses.
- Our use and disclosure of personally identifiable information, including health information, is subject to federal and state privacy and security regulations, and our failure to comply with those regulations or to adequately secure the information we hold could result in significant liability or reputational harm.

Legal and Regulatory Risks

- If we fail to comply with or otherwise incur liabilities under the numerous federal and state laws and regulations relating to the operation of our facilities, we could incur significant penalties or other costs or be required to make significant changes to our operations.
- Our surgical facilities do not satisfy the requirements for any of the safe harbors under the federal Anti-Kickback Statute. If a federal or state agency asserts a different position or enacts new laws in this regard, we could be subject to criminal and civil penalties, loss of licenses and exclusion from governmental programs, which may result in a substantial loss of revenue.
- If we fail to comply with physician self-referral laws as they are currently interpreted or may be interpreted in the future, or if other legislative restrictions are issued, we could incur substantial monetary penalties and a significant loss of revenue.
- Federal law restricts the ability of our surgical hospitals to expand surgical capacity.
- Companies within the health care industry, including us, continue to be the subject of federal and state audits and investigations, including actions for false and other improper claims.
- If we become subject to large malpractice or other legal claims, we could be required to pay significant damages, which may not be covered by insurance.
- Failure to comply with Medicare's conditions for coverage and conditions of participation may result in loss of program payment or other governmental sanctions.
- Our facilities could face decreased Medicare payments if they fail to report and meet various quality metrics.
- If antitrust enforcement authorities conclude that our market share in any particular market is too concentrated, that our or our health system partners' commercial payor contract negotiating practices are illegal, or that we otherwise violate antitrust laws, we could be subject to enforcement actions that could have a material adverse effect on our business, prospects, results of operations and financial condition.

Governance Risks

- We are a "controlled company" within the meaning of Nasdaq rules and, therefore, we qualify for, and currently rely on, exemptions from certain corporate governance requirements.
- Our controlling stockholder has significant influence over us, including control over decisions that require the approval of stockholders, which could limit our stockholders' ability to influence the outcome of key transactions, including a change of control.
- Provisions in the certificate of designation governing our preferred stock and in our charter documents and Delaware law may deter takeover efforts that could be beneficial to stockholder value.
- Our amended and restated certificate of incorporation designates courts in the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.

Risk Factors

We are subject to risks and uncertainties that could cause our actual financial condition, results of operations, business and prospects to differ materially from those described in the forward-looking statements contained in this report or in our other filings with the SEC. Some of these risks and uncertainties are discussed below. If any of the following risks, or other risks and uncertainties, actually occurred, our business, financial condition and operating results could suffer.

COVID-19 and Other Potential Pandemic Risks

The COVID-19 global pandemic continues to significantly affect our operations, business and financial condition, and our liquidity could continue to be negatively impacted further if the U.S. economy remains unstable for a significant amount of time or it takes an extended period for patient volumes at our facilities to recover to pre-COVID-19 pandemic levels.

The COVID-19 pandemic has significantly affected our facilities, employees, patients, communities, business operations and financial performance, as well as the U.S. economy and financial markets. The COVID-19 crisis is still rapidly evolving and much of its impact remains unknown and difficult to predict; however, it has adversely affected our business operations since March, has materially impacted our financial performance for the remainder of 2020, and potentially could negatively impact our financial performance in 2021.

We continue to take or support measures to try to slow the spread and minimize the impact of the virus on our business. Beginning mid-March, the COVID-19 pandemic began to negatively affect our net revenue and business operations. Due in part to local, state and federal guidelines as well as recommendations from major medical societies regarding social distancing and self-quarantines in response to the COVID-19 pandemic, we cancelled or postponed a substantial percentage of the elective procedures scheduled at our facilities and reduced operating hours at a significant number of our facilities. As a result, our facilities experienced significantly lower surgical case volume, which was more significant at the beginning of the second quarter and has improved gradually as states re-opened and allowed for non-emergent procedures. The impact of the COVID-19 pandemic on our surgical facilities varies based on the market in which the facility operates, the type of surgical facility and the procedures that are typically performed. It is difficult to predict the duration of this lower surgical case volume and, while governmental restrictions are continuing to ease in certain areas of the U.S., other areas are experiencing a surge in COVID-19 cases and may impose, re-impose or consider the imposition of additional restrictions in response. We cannot predict the timing of the potential recapture of cancelled or postponed procedures, if any.

Even after taking into account actions that we are taking intended to increase financial flexibility, the volume reductions we have experienced have resulted in materially lower revenue and material decreases in income from operations during 2020, and may potentially continue to do so for subsequent quarters. We cannot predict if or when utilization may return to pre-pandemic levels. Additionally, some of our actions to increase liquidity could result in increased expenses, reduced employee morale, labor unrest and work stoppages or other workforce disruptions.

We experienced, and in the future could experience, supply chain disruptions, including shortages and delays, and could experience significant price increases, in equipment, pharmaceuticals and medical supplies, particularly personal protective equipment or PPE. Staffing, equipment, and pharmaceutical and medical supplies shortages may also impact our ability to serve patients at our facilities.

Broad economic factors resulting from the current COVID-19 pandemic, including increasing unemployment rates and reduced consumer spending, could also negatively affect our payor mix, increase the relative proportion of lower margin services we provide and reduce patient volumes, as well as diminish our ability to collect outstanding receivables. Business closings and layoffs in the areas in which we operate may lead to increases in the uninsured and underinsured populations and adversely affect demand for our services, as well as the ability of patients and other payors to pay for services as rendered. Any increase in the amount or deterioration in the collectability of patient accounts receivable will adversely affect our cash flows and results of operations, requiring an increased level of working capital. If general economic conditions continue to deteriorate or remain uncertain or diminished for an extended period of time, our liquidity and ability to repay our outstanding debt may be harmed.

In addition, our results and financial condition may be further adversely affected by future federal or state laws, regulations, orders, or other governmental or regulatory actions addressing the current COVID-19 pandemic or the U.S. health care system, which, if adopted, could result in direct or indirect restrictions to our business, financial condition, results of operations and cash flow.

The foregoing and other continued disruptions to our business as a result of the COVID-19 pandemic (including the potential resurgences of COVID-19 in jurisdictions currently engaged in reopening) have had and are likely to continue to have a material adverse effect on our business and could have a material adverse effect on our results of operations, financial condition, cash flows and our ability to service our indebtedness.

Finally, although we have received grants and accelerated payments under the CARES Act, we are reviewing and may seek any additional available benefits in the future under the CARES Act, the COVID-19 Economic Relief Bill (together, the "Relief Bills") or other existing or any future legislation passed that could benefit us. We cannot predict the manner in which such future benefits will be allocated or administered, and we cannot assure you that we will be able to access such benefits in a timely manner or at all. Certain of the programs we seek to access under the Relief Bills have not previously been administered on the present scale or at all. Government or third party program administrators may be unable to cope with the volume of applications in the near term. There can be no assurance that the implementation or interpretation of the provisions of the Relief Bills or other legislation will not change in ways that affect our funding or eligibility to participate, or that changes to the terms of such programs will not result in government recoupment of funds that were initially released to us as grants. Additionally, accessing these programs and our response to the COVID-19 pandemic have required our management team to devote extensive resources and is likely to continue to do so in the near future, which may negatively affect our ability to implement our business plan and respond to opportunities.

Furthermore, currently there is limited guidance available regarding the accounting treatment of funds that have been received by us and our facilities under the CARES Act. This lack of guidance requires us to apply professional judgement and make certain estimates and assumptions with respect to the presentation, amount and timing of our recognition of grant funds received under the CARES Act. For example, HHS published updated guidance in September 2020 regarding how we should apply grant funds, which required us to make

certain changes to our estimation procedures for the recognition of grant funds during the three months ended September 30, 2020. Subsequently, in December 2020, the COVID-19 Economic Relief Bill was signed into law, which required us to make further changes to our estimation procedures for the recognition of grant funds again during the three months ended December 31, 2020. We continue to monitor regulatory guidance published by HHS related to the required attestation guidance, which may require us to make additional changes to our estimation procedures for the recognition of grant funds in 2021.

A pandemic, epidemic or outbreak of a contagious disease in the markets in which we operate or that otherwise impacts our facilities could adversely impact our business.

If a pandemic, epidemic or outbreak of an infectious disease, including the recent outbreak of respiratory illness caused by a novel coronavirus known as COVID-19, or other public health crisis were to affect the areas in which we operate, our business, including our revenue, profitability and cash flows, could be adversely affected. If any of our facilities were involved, or perceived to be involved, in treating patients with a highly contagious disease, or there was an outbreak of a highly contagious disease in areas in which our surgical centers are located, our patients might cancel or defer elective procedures or otherwise avoid medical treatment. This could result in reduced patient volumes and operating revenues, potentially over an extended period. Further, a pandemic, epidemic or outbreak of an infectious disease might adversely impact our business by causing temporary shutdowns of our facilities or diversion of patients or by causing staffing shortages in our facilities. We may be unable to locate replacement supplies, and ongoing delays could require us to reduce procedure volume or cause temporary shutdowns of our facilities. Although we have disaster plans in place and operate pursuant to infectious disease protocols, the extent to which COVID-19 or other public health crisis will impact our business is difficult to predict and will depend on many factors beyond our control, including the speed of contagion, the development and implementation of effective preventative measures and possible treatments, the scope of governmental and other restrictions on travel and other activity, and public reactions to these factors.

Business and Operational Risks

We depend on payments from third-party payors, including government health care programs and private insurance organizations. If these payments are reduced or eliminated, our revenue and profitability could be materially and adversely affected.

We depend upon private and governmental third-party sources of payment for the services provided by physicians in our physician network and to patients in our surgical facilities, including surgical hospitals. We derived approximately 39% in both 2020 and 2019 and 38% in 2018, of our revenue from government payors, including Medicare and Medicaid programs. The amounts that we receive from the Medicare and Medicaid programs for our services are subject to statutory and regulatory changes, administrative rulings, interpretations and determinations concerning patient eligibility requirements, funding levels and the method of calculating payments or reimbursements, among other things; refinements to the Medicare Ambulatory Surgery Center payment system and refinements made by CMS to Medicare's reimbursement policies; requirements for utilization review; and federal and state funding restrictions; any of which could materially adversely affect payments we receive from these government programs, as well as affect the timing of payments to our facilities.

During the past several years, health care payors, such as federal and state governments, insurance companies and employers, have undertaken initiatives to revise payment methodologies and monitor health care costs. As part of their efforts to contain health care costs, payors increasingly are demanding discounted fee structures or the assumption by health care providers of all or a portion of the financial risk relating to paying for care provided, often in exchange for exclusive or preferred participation in their benefit plans. We expect efforts to impose greater discounts and more stringent cost controls by government and other payors to continue, thereby reducing the payments we receive for our services. Similarly, private third-party payors may be successful in negotiating reduced reimbursement schedules with our facilities.

Fixed fee schedules, capitation payment arrangements, exclusion from participation in or inability to reach agreements with private insurance organizations, reduction or elimination of payments or an increase in the payments at a rate that is less than the increase in our costs, or other factors affecting payments for health care services over which we have no control could have a material adverse effect on our business, prospects, results of operations and financial condition.

If we are unable to negotiate and enter into favorable contracts or maintain satisfactory relationships and renew existing contracts on favorable terms with private insurance payors, our revenue and profitability may decrease.

Payments from private insurance payors, including state workers' compensation programs and managed care organizations, represented approximately 54% in both 2020 and 2019 and 55% in 2018, of our patient service revenue. Most of these payments came from private insurance payors with which our facilities have contracts. Managed care companies such as HMOs and PPOs, which offer prepaid and discounted medical service packages, represent a growing segment of private insurance payors. If we fail to enter into favorable contracts or maintain satisfactory relationships with private insurance organizations, our revenue may decrease. Our competitive position has been, and will continue to be, affected by initiatives undertaken during the past several years by major purchasers of health care services, including insurance companies and employers, to revise payment methods and monitor health care expenditures in an effort to contain health care costs. For instance, private insurance payors may lower reimbursement rates in response to increased obligations on payors imposed by the Affordable Care Act or future reductions in Medicare reimbursement rates. Further, private insurance payors may narrow their provider networks in response to the need to negotiate lower reimbursement rates with providers. If we are unable to maintain strong relationships with these payors, we may not be able to participate in these narrow provider networks.

Some of our payments from private insurance payors come from payors with which our facilities or subsidiaries do not have a contract. If we provide services to a patient that does not use a private insurance payor with which we have contracted, commonly known as "out-of-network" services, we generally charge the patient the same co-payment or other patient responsibility amounts that we would have charged had our facilities had a contract with the payor. In accordance with insurance laws and regulations, we submit a claim for the services to the payor along with full disclosure that our surgical facility has charged the patient an in-network patient responsibility amount. Historically, it was typical for those private insurance payors who do not have contracts with our surgical facilities to pay our claims at higher than comparable contracted rates. However, in recent years we have observed an increase in private insurance payors adopting out-of-network fee schedules that are more comparable to our contracted rates or to take other steps to discourage their enrollees from seeking treatment at out-of-network surgical facilities. If the proportion of our services subject to out-of-network fee schedules increases, we may experience a decrease in volume at our ASCs or other facilities due to fewer referrals of out-of-network patients.

Additionally, payments from workers' compensation payors represented approximately 6% of our patient service revenue in both 2020 and 2019, and approximately 5% of our patient service revenues in 2018. A majority of states have implemented workers' compensation provider fee schedules. In some cases, the fee schedule rates contain lower rates than the rates our surgical facilities have historically been paid for the same services. If states reduce the amounts paid to providers under the workers' compensation fee schedules, it could have an adverse impact on our operating results.

Significant changes in our payor mix or surgical case mix resulting from fluctuations in the types of cases performed at our facilities could have a material adverse effect on our business, prospects, results of operations and financial condition.

Our results may change from period to period due to fluctuations in payor mix or case mix or other factors relating to the type of cases performed at our facilities. Payor mix refers to the relative share of total cases provided to patients with no insurance, private insurance, Medicare coverage and Medicaid coverage. Since, generally speaking, we receive relatively higher payment rates from private insurers than Medicare, Medicaid and other government-funded programs, a significant shift in our payor mix toward a higher percentage of Medicare and Medicaid cases, which could occur for reasons beyond our control, could have an adverse effect on our business, prospects, results of operations and financial condition.

Case mix refers to the relative share of total cases performed by specialty, such as GI, general surgery, ophthalmology, orthopedic and pain management. Generally speaking, certain types of our cases, such as orthopedic cases, generate relatively higher revenue than other types of cases, such as pain management and GI cases. Therefore, a significant shift in our case mix toward a higher percentage of lower revenue cases, which could occur for reasons beyond our control, could result in a material adverse effect on our business, prospects, results of operations and financial condition.

Our case volume and surgical case mix may be adversely affected by patients' unwillingness to pay for procedures in our facilities. Higher numbers of unemployed individuals generally translates into more individuals without health care insurance to help pay for procedures, thereby increasing the potential for persons to elect not to have procedures performed. Even procedures normally thought to be non-elective may be delayed or may not be performed if the patient cannot afford the procedure due to a lack of insurance or money to pay their portion of our facilities' fee. It is difficult to predict the degree to which our business will continue to be impacted by economic conditions in the future.

As we operate in multiple markets, each with a different competitive landscape, shifts within our payor mix or case mix may not be uniform across all of our affiliated facilities. Rather, these shifts may be concentrated within certain markets due to local competitive factors. Therefore, the results of our individual affiliated facilities, including facilities that are material to our results, may be volatile, which could result in a material adverse effect on our business, prospects, results of operations and financial condition.

Our ability to provide medical services at our facilities would be impaired and our revenue reduced if we are not able to maintain good relationships with affiliated physicians who utilize our surgical facilities.

Our business depends, among other things, upon the efforts and success of affiliated physicians who provide medical services at our surgical facilities and the strength of our relationships with these physicians. We generally do not enter into contracts with physicians who use our surgical facilities, other than partnership and operating agreements with physicians who own interests in our surgical facilities, agreements for anesthesiology services and medical director agreements. Most physicians are not employees of our surgical facilities and are not contractually required to use our facilities. Physicians who use our surgical facilities also use other facilities or hospitals and may choose to perform procedures in an office-based setting that might otherwise be performed at our surgical facilities. In recent years, pain management and gastrointestinal procedures have been performed increasingly in an office-based setting because of potential cost savings or better access for patients and physicians. Although physicians who own interests in our surgical facilities are subject to agreements restricting ownership of competing facilities, these agreements may not restrict procedures performed in a physician office or in other unrelated facilities. Also, these agreements restricting ownership of competing facilities are difficult to enforce, and we may be unsuccessful in preventing physicians who own interests in our surgical facilities from acquiring interests in competing facilities.

The financial success of our facilities is in part dependent upon the volume of procedures performed by the physicians who use our facilities, which can be affected by the economy, health care reform efforts, increases in patient co-payments and deductibles and other factors outside our or their control. The physicians who use our surgical facilities may choose not to accept patients who pay for services through certain third-party payors, which could reduce our revenue. From time to time, we may have disputes with physicians who use our surgical facilities and/or own interests in our surgical facilities or our Company. Our revenue and profitability could be significantly

reduced if we lost our relationship with one or more key physicians or groups of physicians, or if such key physician or group of physicians reduce their use of any of our surgical facilities. In addition, any damage to the reputation of a key physician or group of physicians or the failure of these physicians to provide quality medical care or adhere to professional guidelines at our surgical facilities could damage our reputation, subject us to liability and significantly reduce our revenue.

Physician treatment methodologies and governmental or private insurance controls designed to reduce the number of surgical procedures may reduce our revenue and profitability.

Controls imposed by Medicare, Medicaid and private insurance payors designed to reduce surgical and other procedure volumes, in some instances referred to as "utilization review," could adversely affect our facilities. Although we are unable to predict the effect these changes will have on our operations, significant limits on the scope of services reimbursed and on reimbursement rates and fees may reduce our revenue and profitability. Additionally, trends in physician treatment protocols and private insurance plan design, such as plans that shift increased costs and accountability for care to patients, could reduce our surgical and other procedure volumes in favor of lower intensity and lower cost treatment methodologies, each of which could, in turn, have a material adverse effect on our business, prospects, results of operations and financial condition.

Our growth strategy depends in part on our ability to integrate operations of acquired surgical facilities, attract new physician partners, and to acquire and develop additional surgical facilities on favorable terms. If we are unable to achieve any of these goals, our future growth could be limited and our operating results could be adversely affected.

We believe that an important component of our financial performance and growth is our ability to provide physicians who use our surgical facilities with the opportunity to purchase ownership interests in our facilities. We may not be successful in attracting new physician investment in our surgical facilities, and that failure could result in a reduction in the quality, efficiency and profitability of our facilities. Based on competitive factors and market conditions, physicians may be able to negotiate relatively higher levels of equity ownership in our facilities, consequently limiting or reducing our share of the profits from these facilities. In addition, physician ownership in our facilities is subject to certain regulatory restrictions.

In addition, our growth strategy includes the acquisition and development of existing surgical facilities and the development of new surgical facilities jointly with local physicians and, in some cases, health care systems and other strategic partners. We are currently evaluating potential acquisitions and development projects and expect to continue to evaluate acquisitions and development projects in the foreseeable future. If we are unable to successfully execute on this strategy in the future, our future growth could be limited. We may be unable to identify suitable acquisition and development opportunities, or to complete acquisitions and new projects in a timely manner and on favorable terms. Further, the businesses or assets we acquire in the future may not ultimately produce returns that justify our related investment.

Our acquisition and development activities, require substantial capital resources, and we may need to obtain additional capital or financing, from time to time, to fund these activities. Historically, we have funded acquisition and development activities through our credit facilities. As a result, we may take actions to fund future acquisitions and development activities that could have a material adverse effect on our business, prospects, results of operations and financial condition, including incurring substantial debt with certain restrictive terms. Further, sufficient capital or financing may not be available to us on satisfactory terms, if at all. In addition, our ability to acquire and develop additional surgical facilities may be limited by state certificate of need programs, licensure requirements, antitrust laws, and other regulatory restrictions on expansion. We also face significant competition from local, regional and national health systems and other owners of surgical facilities in pursuing attractive acquisition candidates. The limited number of surgical facilities we develop typically incur losses in their early months of operation (more so in the case of surgical hospitals) and, until their case loads grow, they generally experience lower total revenue and operating margins than established surgical facilities, and we expect this trend to continue.

If we are not successful in integrating the operations and personnel of newly acquired surgical facilities in a timely and efficient manner, then the potential benefits of the transaction may not be realized and our operations and earnings could be materially adversely impacted. If we experience the loss of key personnel or if the effort devoted to the integration of acquired facilities diverts significant management or other resources from other operational activities, our operations could be impaired. Additionally, in some acquisitions, we may have to renegotiate, or risk losing, one or more of the facility's private insurance contracts. We may also be unable to immediately collect the accounts receivable of an acquired facility while we align the payors' payment systems and accounts with our own systems. Finally, certain transactions can require licensure changes which, in turn, result in disruptions in payment for services.

In addition, although we conduct extensive due diligence prior to the acquisition of surgical facilities and seek indemnification from prospective sellers covering unknown or contingent liabilities, we may acquire facilities with unknown or contingent liabilities, including liabilities for failure to comply with health care laws and regulations for which we do not have sufficient insurance or indemnification rights.

Our rapid growth has placed, and will continue to place, increased demands on our management, operational and financial information systems and other resources. Furthermore, expansions into new geographic markets and services may require us to comply with new and unfamiliar legal and regulatory requirements, which could impose substantial obligations on us and our management, cause us to expend additional time and resources, and increase our exposure to penalties or fines for non-compliance with such requirements. To accommodate our past and anticipated future growth, and to compete effectively, we will need to continue to improve our management, operational and financial information systems and to expand, train, manage and motivate our workforce. Our personnel, systems, procedures or controls

may not be adequate to support our operations in the future. Further, focusing our financial resources and management attention on the expansion of our operations may negatively impact our financial results. Any failure to improve our management, operational and financial information systems, or to expand, train, manage or motivate our workforce, could reduce or prevent our growth.

Shortages of surgery-related products, equipment and medical supplies and quality control issues with such products, equipment and medical supplies could disrupt our operations and adversely affect our case volume, surgical case mix and profitability.

Our operations depend significantly upon our ability to obtain sufficient surgery-related products, drugs, equipment and medical supplies from suppliers on a timely and cost-effective basis. If we are unable to obtain such necessary products, or if we fail to properly manage existing inventory levels, the surgical facilities may be unable to perform certain surgeries, which could adversely affect case volume or result in a negative shift in surgical case mix. In addition, as a result of shortages, we could suffer, among other things, operational disruptions, disruptions in cash flows, increased costs and reductions in profitability. At times, supply shortages have occurred in our industry, and such shortages may be expected to recur from time to time.

Medical supplies and services can also be subject to supplier product quality control incidents and recalls. In addition to contributing to materials shortages, product quality can affect patient care and safety. Material quality control incidents have occurred in the past and may occur again in the future, for reasons beyond our control, and such incidents can negatively impact case volume, product costs and our reputation. In addition, we may have to incur costs to resolve quality control incidents related to medical supplies and services regardless of whether they were caused by us. Our inability to obtain the necessary amount and quality of surgery-related products, equipment and medical supplies due to a quality control incident or recall could have a material adverse effect on our business, prospects, results of operations and financial condition.

We face competition from other health care facilities and providers.

The health care business is highly competitive and each of the individual geographic areas in which we operate has a different competitive landscape. In each of our markets we compete with other health care providers for patients and in contracting with private insurance payors. In addition, because the number of physicians available to utilize and invest in our facilities is finite, we face intense competition from other surgery centers, hospitals, health systems and other health care providers in recruiting physicians to utilize and invest in our facilities. We are in competition with other surgery centers, hospitals and health care systems in the communities we serve to attract patients and provide them with the care they need.

There are also unaffiliated hospitals in each market in which we operate. These hospitals have established relationships with physicians and payors. In addition, other companies either currently are in the same or similar business of developing, acquiring and operating surgical facilities or may decide to enter our business. Many of these companies have greater resources than we do, including financial, marketing, staff and capital resources. We also may compete with some of these companies for entry into strategic relationships with health care systems and health care professionals. In addition, many physician groups develop surgical facilities without a corporate partner. In recent years, more physicians are choosing to perform procedures, including pain management and gastrointestinal procedures, in an office-based setting rather than in a surgical facility. If we are unable to compete effectively with any of these entities or groups, we may be unable to implement our business strategies successfully and our financial position and results of operations could be adversely affected.

Competition for physicians and clinical personnel, including nurses, shortages of qualified personnel or other factors could increase our labor costs and adversely affect our revenue, profitability and cash flows.

Our operations are dependent on the efforts, abilities and experience of our physicians and clinical personnel. We compete with other health care providers, primarily hospitals and other surgical facilities, in attracting physicians to utilize our surgical facilities, nurses and medical staff to support our surgical facilities, recruiting and retaining qualified management and support personnel responsible for the daily operations of each of our facilities and in contracting with private insurance payors in each of our markets. In some markets, the lack of availability of clinical personnel, such as nurses, has become a significant operating issue facing all health care providers. This shortage may require us to continue to enhance wages and benefits to recruit and retain qualified personnel or to contract for more expensive temporary personnel. For the year-ended December 31, 2020, our salary and benefit expenses represented approximately 30% of our revenue. We also depend on the available labor pool of semi-skilled and unskilled workers in each of the markets in which we operate.

If our labor costs increase, we may not be able to raise rates to offset these increased costs. Because a significant percentage of our revenue consists of fixed, prospective payments, our ability to pass along increased labor costs is limited. In particular, if labor costs rise at an annual rate greater than our net annual consumer price index basket update from Medicare, our results of operations and cash flows will likely be adversely affected. Any union activity at our facilities that may occur in the future could contribute to increased labor costs. Certain proposed changes in federal labor laws and the National Labor Relations Board's modification of its election procedures could increase the likelihood of employee unionization attempts. Although none of our employees are currently represented by a collective bargaining agreement, to the extent a significant portion of our employee base unionizes, it is possible our labor costs could increase materially. Our failure to recruit and retain qualified management and medical personnel, or to control our labor costs, could have a material adverse effect on our business, prospects, results of operations and financial condition.

Some jurisdictions preclude us from entering into non-compete agreements with our physicians, and other non-compete agreements and restrictive covenants applicable to certain physicians and other clinical employees may not be enforceable.

We have contracts with physicians and other health professionals in many states. Some of our physician services contracts, as well as many of our physician services contracts with hospitals, include provisions preventing these physicians and other health professionals from competing with us both during and after the term of our contract with them. The law governing non-compete agreements and other forms of restrictive covenants varies from state to state. Some jurisdictions prohibit us from entering into non-compete agreements with our professional staff. Other states are reluctant to strictly enforce non-compete agreements and restrictive covenants against physicians and other health care professionals. Therefore, there can be no assurance that our non-compete agreements related to employed or otherwise contracted physicians and other health professionals will be enforceable if challenged in certain states. In such event, we would be unable to prevent former employed or otherwise contracted physicians and other health professionals from competing with us, potentially resulting in the loss of some of our hospital contracts and other business. Additionally, certain facilities have the right to employ or engage our providers after the termination or expiration of our contract with those facilities and cause us not to enforce our non-compete provisions related to those providers.

Our surgical facilities are sensitive to regulatory, economic and other conditions in the states where they are located.

Our revenue is particularly sensitive to regulatory, economic and other conditions in the states of Georgia and Texas. As of December 31, 2020, we owned and operated nine consolidated surgical facilities in Texas and six consolidated surgical facilities in Georgia. The Texas facilities represented approximately 14% of our revenue in fiscal 2020 and the Georgia facilities represented approximately 11% of our revenue in fiscal 2020.

In addition, we own and operate three consolidated surgical facilities in Idaho, representing approximately 25% of our revenue during fiscal 2020. These surgical facilities also provide ancillary services, including physician practices, radiation oncology and anesthesia services. If there were an adverse regulatory, economic or other development in any of the states in which we have a higher concentration of facilities, including Idaho, our case volumes could decline in such states or there could be other unanticipated adverse impacts on our business in those states, which could have a material adverse effect on our business, prospects, results of operations and financial condition.

If any of our existing health care facilities lose their accreditation status or any of our new facilities fail to receive accreditation, such facilities could become ineligible to receive reimbursement under Medicare or Medicaid or other third-party payors.

The construction and operation of health care facilities are subject to extensive federal, state and local regulation relating to, among other things, the adequacy of medical care, equipment, personnel, operating policies and procedures, fire prevention, rate-setting and compliance with building codes and environmental protection. Additionally, such facilities are subject to periodic inspection by government authorities and accreditation organizations to assure their continued compliance with these various standards.

All of our facilities are deemed certified, meaning that they are accredited, properly licensed under the relevant state laws and regulations and certified under the Medicare program or are in the process of applying for such accreditation, licensing or certification. The effect of maintaining certified facilities is to allow such facilities to participate in the Medicare and Medicaid programs. We believe that all of our facilities are in material compliance with applicable federal, state, local and other relevant accreditation and certification regulations and standards. However, should any of our health care facilities lose their deemed certified status and thereby lose certification under the Medicare or Medicaid programs, such facilities would be unable to receive reimbursement from either or both of those programs, and possibly from other third-party payors, and our business could be materially adversely affected.

Certain of our partnership and operating agreements contain provisions giving rights to our partners and other members that may be adverse to our interests.

Certain of the agreements governing the limited partnerships ("LPs"), general partnerships ("GPs") and limited liability companies ("LLCs") through which we own and operate our facilities contain provisions that give our partners or other members rights that may, in certain circumstances, be adverse to our interests. These rights include, but are not limited to, rights to purchase our interest in the partnership or LLC, rights to require us to purchase the interests of our partners or other members, or rights requiring the consent of our partners and other members prior to our transferring our ownership interest in a facility or prior to a change in control of us or certain of our subsidiaries. With respect to these purchase rights, the agreements generally include a specified formula or methodology to determine the applicable purchase price, which may or may not reflect fair market value.

Additionally, many of our partnership and operating agreements contain restrictions on actions that we can take, even though we may be the general partner or the managing member. Examples of these restrictions include the rights of our partners and other members to approve the sale of substantially all of the assets of the partnership or LLC, to dissolve the partnership or LLC, to appoint a new or additional general partner or managing member and to amend the partnership or operating agreements. Many of our agreements also restrict our ability in certain instances to compete with our existing facilities or with our partners. Where we hold only a limited partner or a non-managing member interest, the general partner or managing member may take certain actions without our consent, although we typically have certain protective rights to approve major decisions such as the sale of substantially all of the assets of the entity, dissolution of the partnership or LLC and the amendment of the partnership or operating agreement. These management and governance rights held by our partners and other members limit and restrict our ability to make unilateral decisions about the management and operation of the facilities without the approval of our partners and other members.

We may have a special legal responsibility to the holders of ownership interests in the entities through which we own our facilities, which may conflict with, and prevent us from acting solely in, our own best interests or the interests of our stockholders.

We generally hold our ownership interests in facilities through LPs, GPs, LLCs or limited liability partnerships ("LLPs") in which we maintain an ownership interest along with physicians and, in some cases, both physicians and health systems. As general partner and manager of most of these entities, we may have a fiduciary duty, to manage these entities in the best interests of the other owners. We also have a duty to operate our business for the benefit of our stockholders. As a result, we may encounter conflicts between our responsibility to the other owners and our responsibility to our stockholders. For example, we have entered into some management agreements to provide management services to our surgical facilities in exchange for a fee. Disputes may arise as to the nature of the services to be provided or the amount of the fee to be paid. In these cases, we may be obligated to exercise reasonable, good faith judgment to resolve the disputes and may not be free to act solely in our own best interests or the stockholders best interest. Disputes may also arise between us and our physician investors with respect to a particular business decision or regarding the interpretation of the provisions of the applicable partnership or limited liability company agreement. We seek to avoid these disputes but have not implemented any measures to resolve these conflicts if they arise. If we are unable to resolve a dispute on terms favorable or satisfactory to us, it could have a material adverse effect on our business, prospects, results of operations and financial condition.

Growth of patient receivables or deterioration in the ability to collect on these accounts, due to changes in economic conditions or otherwise, could have a material adverse effect on our business, prospects, results of operations and financial condition.

The current practice of providing medical services in advance of payment or, in many cases, prior to assessment of ability to pay for such services, may have significant negative impact on our revenue and cash flow. We bill numerous and varied payors, such as self-pay patients, private insurance payors and Medicare and Medicaid. These different payors typically have different billing requirements that must be satisfied prior to receiving payment for services rendered. Reimbursement is typically conditioned on our documenting medical necessity and correctly applying diagnosis codes. Incorrect or incomplete documentation and billing information could result in non-payment for services rendered. The primary collection risks with respect to our patient receivables relate to patient accounts for which the primary third-party payor has paid the amounts covered by the applicable agreement, but patient responsibility amounts (deductibles and co-payments) remain outstanding.

Additional factors that could complicate our billing include:

- disputes between payors as to which party is responsible for payment;
- failure of information systems and processes to submit and collect claims in a timely manner;
- variation in coverage for similar services among various payors;
- the difficulty of adherence to specific compliance requirements, diagnosis coding and other procedures mandated by various payors; and
- failure to obtain proper physician credentialing and documentation in order to bill various payors.

Due to the difficulty in assessing future trends, including the effects of changes in economic conditions, an increase in the amount of patient receivables or a deterioration in the collectability of these receivables could have a material adverse effect on our business, prospects, results of operations and financial condition.

If we are unable to integrate and operate our information systems effectively or implement new systems and processes, our operations could be disrupted.

Our operations depend significantly on effective information systems, which require continual maintenance, upgrading and enhancement to meet our operational needs. Any system failure or integration delay that causes an interruption in service or availability of our systems could adversely affect operations or delay the collection of revenue. Moreover, we use the development and implementation of sophisticated and specialized technology to improve our profitability, and our acquired surgical centers and hospitals will require frequent transitions and integration of various information systems. If we are unable to properly integrate other information systems or expand our current information systems it may have an adverse effect on our ability to obtain new business, retain existing business and maintain or increase our profit margins and we could suffer, among other things, operational disruptions, disruptions in cash flows and increases in administrative expenses.

Financial and Accounting Risks

We have a history of net losses and may not achieve or sustain profitability in the future.

We had net losses attributable to Surgery Partners, Inc. of \$116.1 million, \$74.8 million and \$205.7 million, in 2020, 2019 and 2018, respectively. We cannot assure you that our revenue will grow or that we will achieve or maintain profitability in the future. Growth of our revenue may slow or revenue may decline and expenses may increase for a number of possible reasons, including reduced demand for our services, regulatory shifts and other risks and uncertainties. Our ability to achieve profitability will be affected by the other risks and uncertainties described in this section and in "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this Annual Report. All of these factors could contribute to future net losses and, if we are unable to meet these risks

and challenges as we encounter them, our business may suffer. If we are not able to achieve, sustain or increase profitability, our business will be adversely affected and our stock price may decline.

Our leverage could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our variable rate debt and prevent us from meeting our obligations under our outstanding indebtedness.

As of December 31, 2020, we and our subsidiaries had approximately \$2.9 billion aggregate principal amount of indebtedness outstanding, which includes approximately \$1.5 billion principal amount of senior secured term loans (the "Term Loan") outstanding, \$370.0 million senior unsecured notes due 2025 (the "2025 Unsecured Notes") and \$545.0 million senior unsecured notes due 2027 (the "2027 Unsecured Notes"). As of December 31, 2020, we had no outstanding borrowings under our \$120.0 million senior secured revolving credit facility (the "Revolver" and, together with the Term Loan, the "Senior Secured Credit Facilities" and, together with the 2025 Unsecured Notes and the 2027 Unsecured Notes, the "Senior Indebtedness"). After giving effect to the \$7.5 million principal amount of outstanding letters of credit issued under our Revolver, we had \$112.5 million of unused commitments available to be borrowed under the Revolver. In addition to the Senior Indebtedness, our aggregate principal amount of indebtedness outstanding includes approximately \$418.7 million of notes payable and finance lease obligations primarily related to property and equipment for operations. Our level of indebtedness increases the risk that we may be unable to generate cash sufficient to pay amounts due in respect of our indebtedness. In addition, subject to applicable restrictions under our Senior Indebtedness, we may incur significant additional indebtedness, which may be secured, from time to time, which could have important consequences, including:

- making it more difficult for us to satisfy our obligations with respect to our indebtedness;
- making us more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in government regulation;
- requiring us to dedicate a substantial portion of our cash flow to making payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limiting our flexibility in reacting to competitive and other changes in our industry and economic conditions generally; and
- limiting our ability to raise additional capital for working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy or other general corporate purposes.

To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control, and any failure to meet our debt service obligations may adversely affect our business, financial condition and results of operations.

Our ability to pay or to refinance our indebtedness and to fund working capital needs and planned capital expenditures will depend upon our future operating performance and our ability to generate cash, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory, business and other factors that are beyond our control.

If our business does not generate sufficient cash flow or if future borrowings are not available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs, we may need to refinance all or a portion of our indebtedness on or before the maturity thereof, sell assets, reduce or delay capital investments or seek to raise additional capital, any of which could have a material adverse effect on our operations. In addition, we may not be able to affect any of these actions, if necessary, on commercially-reasonable terms or at all. Our history of net losses may impair our ability to service our indebtedness or repay outstanding amounts when they become due. In addition, our ability to restructure or refinance our indebtedness will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, and also might include incurring additional fees in connection with refinancing, which could further restrict our business operations. The terms of existing or future debt instruments may limit or prevent us from taking any of these actions. In addition, any failure to make scheduled payments of interest and principal on our outstanding indebtedness would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness on commercially-reasonable terms or at all. Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance or restructure our obligations on commercially reasonable terms or at all, may adversely affect our business, financial condition and results of operations.

Restrictive covenants in our debt instruments may adversely affect us.

The Senior Indebtedness imposes significant operating and financial restrictions and limit the ability of us and our restricted subsidiaries to, among other things:

- incur additional indebtedness and guarantee indebtedness;
- pay dividends or make other distributions in respect of, or repurchase or redeem, capital stock;
- prepay, redeem or repurchase certain debt;
- make loans and investments;
- sell or otherwise dispose of assets;

- sell stock of our subsidiaries;
- incur liens;
- enter into transactions with affiliates;
- enter into agreements restricting certain of our subsidiaries' ability to pay dividends; and
- consolidate, merge or sell all or substantially all of our assets.

As a result of these and other covenants and restrictions, we are and will be limited in how we conduct our business, and we may be unable to raise additional capital to compete effectively or to take advantage of new business opportunities. In addition, we may be required to maintain specified financial maintenance ratios and satisfy other financial condition tests in connection with the Senior Indebtedness. The terms of any future indebtedness we may incur could include more restrictive covenants. We cannot assure you that we will be able to maintain compliance with these covenants in the future and, if we fail to do so, that we will be able to obtain waivers from the lenders and/or amend the covenants. Our failure to comply with the restrictive covenants described above as well as others contained in our future debt instruments from time to time could result in an event of default, which, if not cured or waived, could result in our being required to repay these borrowings before their maturity. If we are forced to refinance these borrowings on less favorable terms, our results of operations and financial condition could be adversely affected.

We cannot assure you that our business will generate sufficient cash flow from operations, that currently anticipated revenue growth and operating improvements will be realized or that future borrowings will be available to us under the Term Loan and Revolver in amounts sufficient to enable us to pay our indebtedness, or to fund our other liquidity needs. If we are unable to meet our debt service obligations or fund our other liquidity needs, we could attempt to restructure or refinance our indebtedness or seek additional equity capital. We cannot assure you that we will be able to accomplish those actions on satisfactory terms, if at all.

Despite our current indebtedness levels, we and our subsidiaries may still be able to incur more debt, which could further exacerbate the risks associated with our leverage.

We and our subsidiaries may be able to incur additional indebtedness in the future, including secured indebtedness. Although the credit agreement governing the Senior Secured Credit Facilities and the indentures governing each of the 2025 Unsecured Notes and 2027 Unsecured Notes, respectively, contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of significant qualifications and exceptions, and the indebtedness incurred in compliance with these restrictions could be substantial.

In addition, as of December 31, 2020 we had approximately \$112.5 million available for additional borrowings under the Revolver (after giving effect to the \$7.5 million aggregate principal amount of outstanding letters of credit issued under our Revolver at such time). If new debt is added to our or our subsidiaries' current debt levels, the related risks that we face would be increased.

We are a holding company with no operations of our own.

We are a holding company, and our ability to service our debt is dependent upon the earnings from the business conducted by our subsidiaries that operate the surgical facilities. The effect of this structure is that we depend on the earnings of our subsidiaries, and the distribution or payment to us of a portion of these earnings to meet our obligations, including those under the Term Loans and Revolving Facility and any of our other debt obligations. The distributions of those earnings, advances or other distributions of funds by these entities to us, all of which are contingent upon our subsidiaries' earnings, are subject to various business considerations. In addition, distributions by our subsidiaries could be subject to statutory restrictions, including state laws requiring that such subsidiaries be solvent, or contractual restrictions. Some of our subsidiaries may become subject to agreements that restrict the sale of assets and significantly restrict or prohibit the payment of dividends or the making of distributions, loans or other payments to stockholders, partners or members.

We make significant loans to, and are generally liable for debts and other obligations of, the partnerships and limited liability companies that own and operate some of our surgical facilities.

We own and operate our surgical facilities through limited partnerships and limited liability companies. Local physicians, physician groups and health care systems also own an interest many of these partnerships and limited liability companies. In the partnerships in which we are the general partner, we are liable for 100% of the debts and other obligations of the partnership, even if we do not own all of the partnership interests. For some of our surgical facilities, indebtedness at the partnership level is funded through intercompany loans that we provide. At December 31, 2020, our intercompany loans totaled \$38.6 million. Through these loans we may have a security interest in the partnership's or limited liability company's assets, depending upon the terms thereof in each instance. However, our financial condition and results of operations would be materially adversely affected if our surgical facilities are unable to repay these intercompany loans, or such loans are challenged under certain health care laws. Additionally, at December 31, 2020, our global intercompany note, which we use to transfer debt balances between our subsidiaries, had a zero balance.

Although most of our intercompany loans are secured by the assets of the partnership or limited liability company, the physicians and physician groups that own an interest in these partnerships and limited liability companies generally do not guarantee a pro rata amount of this debt or the other obligations of these partnerships and limited liability companies.

From time to time, we may guarantee our pro-rata share of the third-party debts and other obligations of our non-wholly owned non-consolidated partnerships and limited liability companies in which we own an interest in an amount proportionate to our pro rata share of

the equity interests issued by such entity. In such instances, the physicians and/or physician groups typically also guarantee their pro-rata share of such indebtedness.

Our variable rate indebtedness subjects us to interest rate risk, which could cause our indebtedness service obligations to increase significantly.

Borrowings under the Senior Secured Credit Facilities are at variable rates of interest and expose us to interest rate risk. If interest rates increase, our debt service obligations on variable rate indebtedness would increase even though the amount borrowed remained the same, and our net income and cash flows, including cash available for servicing our indebtedness, would correspondingly decrease. We periodically enter into interest rate swap agreements to manage our exposure to these fluctuations. Our interest rate swap agreements involve the exchange of fixed and variable rate interest payments between two parties, based on common notional principal amounts and maturity dates. The notional amounts of the swap agreements represent balances used to calculate the exchange of cash flows and are not our assets or liabilities.

Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations.

The Senior Secured Credit Facilities bear interest at a rate per annum equal to (x) the London Interbank Offered Rate ("LIBOR") plus a margin ranging from 3.00% to 3.25% per annum, depending on the Company's first lien net leverage ratio or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.50% per annum above the federal funds effective rate and (iii) one-month LIBOR plus 1.00% per annum (solely with respect to the Term Loan, the alternate base rate shall not be less than 2.00% per annum)) plus a margin ranging from 2.00% to 2.25% per annum. In addition, the Company is required to pay a commitment fee of 0.50% per annum in respect of unused commitments under the Revolver. The 2020 incremental term loans bear interest at a rate per annum equal to (x) LIBOR plus a margin of 8.00% per annum or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate, (iii) one-month LIBOR plus 1.00% per annum and (iv) 2.00% per annum) plus a margin of 7.00% per annum.

Discontinuation, reform or replacement of LIBOR may adversely affect our business.

The credit agreement governing the Senior Secured Credit Facilities permits interest on borrowings to be calculated based on LIBOR. LIBOR and certain other interest "benchmarks" may be subject to regulatory guidance and/or reform that could cause interest rates under our current or future debt agreements to perform differently than in the past or cause other unanticipated consequences. The United Kingdom's Financial Conduct Authority, which regulates LIBOR, has announced that it intends to phase out LIBOR by June 2023. If the phase out occurs as planned, the interest rate applicable to our variable rate debt may be calculated based on an alternative, comparable or successor rate which may have a material adverse impact on the cost of the variable rate portion of our indebtedness. The timing and result of the phase out of LIBOR are unclear, and efforts of industry groups to develop a suitable successor are not guaranteed to result in a viable or widely adopted replacement for LIBOR. If LIBOR becomes unavailable before a suitable replacement is widely adopted, it could have a material adverse impact on the availability of variable rate financing.

As of December 31, 2020, we also had interest rate swap agreements based on LIBOR. If LIBOR becomes unavailable, it is unclear how payments under those agreements would be calculated. Relevant industry groups are seeking to create a standard protocol addressing the expected discontinuation of LIBOR, but there can be no assurance that such a protocol will be developed or implemented with respect to our swap agreements.

We may be limited in our ability to utilize, or may not be able to utilize, net operating loss carryforwards to reduce our future tax liability.

As of December 31, 2020, we had U.S. federal net operating loss ("NOL") carryforwards of approximately \$615.7 million and state NOL carryforwards of approximately \$678.9 million, which may be limited annually due to certain change in ownership provisions of Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"). In addition, as a result of the Symbion acquisition, approximately \$179 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$4.9 million, and, as a result of the Novamed acquisition, approximately \$17 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$4.9 million. As a result of our acquisition of NSH Holdco, Inc. ("NSH") on August 31, 2017, approximately \$20.5 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$2.8 million. Further, the sale of H.I.G. Surgery Centers, LLC's ("H.I.G.") shares to Bain Capital in connection with the Transactions resulted in an ownership change as defined in Section 382. As a result, we will not be able to use our pre-ownership-change NOLs in excess of the limitation imposed by Section 382. These limitations, when combined with amounts allowable due to net unrecognized built in gains, are not expected to impact the realization of the deferred tax assets associated with these NOLs. \$516.2 million of our federal NOL carryforwards will begin to expire in 2026 and will completely expire in 2037. The remaining federal NOL carryforwards, which were generated subsequent to 2017, do not expire. Our state NOL carryforwards will begin to expire in 2021 and will completely expire in 2040. Future ownership changes may subject our NOL carryforwards to further annual limitations, which could restrict our ability to use them to offset our taxable income in periods following the ownership changes.

We entered into a tax receivable agreement that will require us to make payments to the pre-IPO owners of Surgery Center Holdings, LLC (the "Pre-IPO Owners"), which amounts are expected to be material.

On September 30, 2015, Surgery Partners, Inc. became the direct parent and sole member of Surgery Center Holdings, LLC (the "Reorganization"). We indirectly acquired favorable tax attributes in connection with the Reorganization. These tax attributes would not be available to us in the absence of the consummation of the Reorganization. As part of the Reorganization, we entered into a tax receivable agreement with the Pre-IPO Owners. In connection with the Transactions completed in August 2017, we entered into an agreement to amend the tax receivable agreement (as amended, the "TRA"), which became effective on August 31, 2017.

Pursuant to the TRA, we agreed to make annual payments to H.I.G. in its capacity as the stockholders representative on behalf of the other pre-Reorganization stockholders pursuant to a fixed payment schedule. The final payment is scheduled to be made in 2024. The amounts payable under the TRA are calculated to equal the product of (i) an annual base amount and (ii) the sum of (x) the maximum corporate federal income tax rate for the applicable year and (y) three percent. The amounts payable under the TRA are related to our projected realized tax savings over the next five years and are not dependent on our actual tax savings over the next five years. The calculations of amounts payable pursuant to the TRA is thus dependent on the maximum corporate federal income tax rate. To the extent that we are unable to make payments under the TRA, such payments will be deferred and will accrue interest at a rate of LIBOR plus 500 basis points until paid. If the terms of credit agreements and other debt documents cause us to be unable to make payments under the TRA and such terms are not materially more restrictive than those existing as of September 30, 2015, such payments will be deferred and will accrue interest at a rate of LIBOR plus 300 basis points until paid. We estimate that the total remaining amounts payable under the TRA as of December 31, 2020 may be as high as \$43.2 million, but the ultimate amounts payable are likely to vary if there are further changes in law as to the income tax rates applicable to domestic corporations.

Our stock price could be volatile, and, as a result, our stockholders may not be able to resell their shares at or above the price paid for them.

Since our initial public offering, the price of our common stock as reported on The Nasdaq Global Select Market has ranged from a low of \$4.00 on March 18, 2020 to a high of \$42.87 on February 2, 2021. The price of our common stock could be subject to fluctuations in response to a number of factors, including those described elsewhere in this report and others such as:

- variations in our operating performance and the performance of our competitors;
- actual or anticipated fluctuations in our quarterly or annual operating results;
- publication of research reports by securities analysts about us or our competitors or our industry;
- announcements by us, our competitors or our vendors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- our failure or the failure of our competitors to meet analysts' projections or guidance that we or our competitors may give to the market;
- strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy;
- the passage of legislation or other regulatory developments affecting us or our industry;
- our limited public float;
- speculation in the press or investment community;
- changes in accounting principles;
- terrorist acts, acts of war or periods of widespread civil unrest;
- natural disasters and other calamities; and
- changes in general market and economic conditions.

Securities class action litigation is often initiated against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources, and could also require us to make substantial payments to satisfy judgments or to settle litigation. For example, see Part I, Item 3. Legal Proceedings - Stockholder Litigation.

Cybersecurity and Data Risks

Cybersecurity attacks or intrusions could adversely impact our businesses.

We, independently and through third-party vendors, collect and store on our networks and devices sensitive information, including intellectual property, proprietary business information and personally identifiable information of our patients and employees. Information security risks have generally increased in recent years because of threats from malicious persons and groups, new vulnerabilities, the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. A failure in or breach of our operational or information security systems as a result of cyber-attacks or information security breaches could disrupt our business,

result in the loss, disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs or lead to fines and financial losses. As a result, cybersecurity and the continued development and enhancement of the controls and processes designed to protect our systems, computers, software, data and networks from attack, damage or unauthorized access remain a priority for us.

We and our third-party vendors have been and likely will continue to be subject to attempted cybersecurity attacks. While there has been no material impact on our business or operations from these attempted attacks. There can be no assurance that we or our third-party vendors will not be subject to cybersecurity incidents that bypass our security measures, impact the integrity, availability or privacy of personal health information or other data subject to privacy laws or disrupt our information systems, devices or business, including our ability to provide various health care services.

The market for cybersecurity insurance is relatively new and coverage available for cybersecurity events may evolve as the industry matures. While we maintain insurance relating to cybersecurity events, such insurance is subject to a number of exclusions and may be insufficient to offset any losses, costs or damage we experience. As cyber threats continue to evolve, we will be required to expend additional resources to continue to enhance our information security measures or to investigate and remediate any information security vulnerabilities.

Our use and disclosure of personally identifiable information, including health information, is subject to federal and state privacy and security regulations, and our failure to comply with those regulations or to adequately secure the information we hold could result in significant liability or reputational harm.

HIPAA as well as numerous other federal and state laws and regulations, govern the collection, dissemination, use, privacy, security, confidentiality, integrity and availability of personally identifiable information ("PII"), including protected health information ("PHI") by covered entities such as us. Ongoing implementation of administrative, physical and technical safeguards, maintenance of policies and procedures governing use and disclosure of PHI, and oversight of compliance with HIPAA requirements involves significant time, effort and expense. While we undertake substantial efforts to secure the PHI we maintain, use and disclose in electronic form, a cyber-attack or other intrusion that bypasses our information security systems causing an information security breach, loss of protected health information or other data subject to privacy laws or a material disruption of our operational systems could result in a material adverse impact on our business, along with potentially substantial fines and penalties.

HIPAA also requires our surgical facilities to use standard transaction code sets and identifiers for certain standardized health care transactions, including billing and other claim transactions. We have undertaken significant efforts involving substantial time and expense to implement these requirements, and we anticipate that continual time and expense will be required to submit standardized transactions and to ensure that any newly acquired facilities can submit HIPAA-compliant transactions.

HIPAA requires covered entities to report breaches of unsecured protected health information to affected individuals without unreasonable delay and in no case later than 60 days after the discovery of the breach by the covered entity or its agents. Notification must also be made to HHS and, in certain situations involving large breaches, to the media. The HIPAA rules created a presumption that all non-permitted uses or disclosures of unsecured protected health information are breaches. HIPAA imposes mandatory civil and criminal penalties for violations of its requirements ranging up to \$50,000 per violation, with a maximum civil penalty of \$1.5 million in a calendar year for violations of the same requirement. However, a single breach incident can result in violations of multiple requirements, resulting in possible penalties well in excess of \$1.5 million. In addition, the HITECH Act authorized state attorneys general to bring civil actions seeking either an injunction or damages in response to violations of HIPAA privacy and security regulations that threaten the privacy of state residents.

HIPAA also authorizes state attorneys general to bring civil actions seeking either an injunction or damages in response to violations of HIPAA privacy and security regulations that threaten the privacy of state residents. While HIPAA does not create a private right of action allowing individuals to sue us in civil court for violations of HIPAA's requirements, its standards have been used as a basis for the duty of care in state civil suits, such as those for negligence or recklessness in the handling of PHI. In addition, HIPAA mandates that the Secretary of HHS conduct periodic compliance audits of HIPAA covered entities such as us.

In addition, many states in which we operate may impose laws that are more protective of the privacy and security of PII than HIPAA. Where these state laws are more protective than HIPAA, we have to comply with their stricter provisions. Only some of these state laws impose fines and penalties upon violators, but some may afford private rights of action to individuals who believe their PII has been misused. California's patient privacy laws, for example, provide for penalties of up to \$250,000 and permit injured parties to sue for damages. Both state and federal laws are subject to modification or enhancement of privacy protection at any time. Our facilities will continue to remain subject to any federal or state privacy-related laws that are more restrictive than the privacy regulations issued under HIPAA. These statutes vary and could impose additional requirements on us and more severe penalties for disclosures of confidential health information. New health information standards could have a significant effect on the manner in which we do business, and the cost of complying with new standards could be significant. We may not remain in compliance with the diverse privacy requirements in all of the jurisdictions in which we do business. If we fail to comply with HIPAA or similar state laws, we could incur substantial civil monetary or criminal penalties.

Legal and Regulatory Risks

If we fail to comply with or otherwise incur liabilities under the numerous federal and state laws and regulations relating to the operation of our facilities, we could incur significant penalties or other costs or be required to make significant changes to our operations.

The health care industry is heavily regulated and we are subject to many laws and regulations at the federal, state and local government levels in the markets in which we operate. These laws and regulations require that our facilities meet various licensing, accreditation, certification and other requirements, including, but not limited to, those relating to:

- ownership and control of our facilities;
- operating policies and procedures;
- qualification, training and supervision of medical and support persons;
- pricing of, billing for and coding of services and properly handling overpayments, debt collection practices and the submission of false statements or claims;
- the necessity, appropriateness and adequacy of medical care, equipment, personnel, operating policies and procedures; maintenance and preservation of medical records;
- financial arrangements between referral sources and our facilities;
- the protection of privacy, including patient and credit card information;
- screening, stabilization and transfer of individuals who have emergency medical conditions and provision of emergency services;
- antitrust;
- building codes;
- workplace health and safety;
- licensure, certification and accreditation;
- fee-splitting and the corporate practice of medicine;
- handling of medication;
- confidentiality, data breach, identity theft and maintenance and protection of health-related and other personal information and medical records; and
- environmental protection, health and safety.

If we fail to comply with applicable laws and regulations, we could subject ourselves to administrative, civil or criminal penalties, cease and desist orders, forfeiture of amounts owed and recoupment of amounts paid to us by governmental or commercial payors, loss of licenses necessary to operate and disqualification from Medicare, Medicaid and other government-sponsored health care programs.

Many of these laws and regulations have not been fully interpreted by regulatory authorities or the courts, and their provisions are sometimes open to a variety of interpretations. Different interpretations or enforcement of existing or new laws and regulations could subject our current practices to allegations of impropriety or illegality, or require us to make changes in our operations, facilities, equipment, personnel, services, capital expenditure programs or operating expenses to comply with the evolving rules. Any enforcement action against us, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business.

A number of initiatives have been proposed during the past several years to reform various aspects of the health care system in the U.S. In the future, different interpretations or enforcement of existing or new laws and regulations could subject our current practices to allegations of impropriety or illegality, or could require us to make changes in our facilities, equipment, personnel, services, capital expenditure programs and operating expenses. In addition, some of the governmental and regulatory bodies that regulate us are considering or may in the future consider enhanced or new regulatory requirements. These authorities may also seek to exercise their supervisory or enforcement authority in new or more robust ways. All of these possibilities, if they occurred, could detrimentally affect the way we conduct our business and manage our capital, either of which, in turn, could have a material adverse effect on our business, prospects, results of operations and financial condition.

We cannot predict the effect that health care reform and other changes in government programs may have on our business, financial condition or results of operations.

The Affordable Care Act has changed and continues to change how health care services are covered, delivered and reimbursed through, among other things, expanded coverage of uninsured individuals, reduced growth in Medicare program spending and the establishment and expansion of programs tying reimbursement to quality and clinical integration. The Affordable Care Act also reforms certain aspects of health insurance, quality of care and fraud and abuse enforcement.

Substantial uncertainty remains regarding the net effect of the Affordable Care Act on our business because the long-term impact of a number of factors, including the following, remains unclear:

- the responses of individuals, businesses and other market participants to the evolving choices and obligations under the Affordable Care Act;
- the states' decisions whether to implement the Medicaid expansion provisions of the Affordable Care Act, and under what terms;
- the effect of value-based purchasing and other quality programs established under the Affordable Care Act;
- the scope and nature of changes to Medicare reimbursement methods and programs, including accountable care organizations, bundled payment programs and other coordinated care models;
- the financial sustainability of the Health Insurance Marketplace, which may be impacted by whether a sufficient number of payors participate;
- our ability to participate in health insurance plans offered through the Health Insurance Marketplaces and the terms of our participation;
- the net effect of reductions in federal health care program spending under the Affordable Care Act; and
- the resolution of new and ongoing legislative and legal challenges to the Affordable Care Act.

As a result of the enactment of the Tax and Jobs Act of 2017, the tax penalty for failure to comply with the "individual mandate" was reduced to zero as of calendar year 2019, effectively repealing the mandate itself. The reduction to zero of the individual mandate tax penalty and any other future repeal or replacement of the Affordable Care Act or any component thereof may have significant impact on the reimbursement for health care services generally, and may cause more individuals to become uninsured, rendering them unable to afford health care services offered by the Company. In addition to proposed legislative changes to the Affordable Care Act, there remains ongoing litigation seeking to repeal the Affordable Care Act in whole or in part. The U.S. Supreme Court recently agreed to hear a case that seeks to invalidate the Affordable Care Act, but it will not issue an opinion until 2021.

Initiatives to repeal the Affordable Care Act, in whole or in part, and to offer amendments or supplements to modify its provisions have been persistent and increased as a result of the 2016 election; however, the results of the 2020 election substantially reduce the likelihood of any successful attempt to repeal the law within the next two years.

Because of the many variables involved, we are unable to predict the net effect of the Affordable Care Act and other associated changes within the health care industry on us or our operations. Depending on how the Affordable Care Act continues to be interpreted, implemented or changed, it could have a material adverse effect on our business, prospects, results of operations and financial condition.

If laws governing the corporate practice of medicine or fee-splitting change, we may be required to restructure some of our relationships, which may result in a significant loss of revenue and divert other resources.

The laws of various states in which we operate or may operate in the future do not permit business corporations to practice medicine, to exercise control over or employ physicians who practice medicine or to engage in various business practices, such as fee-splitting with physicians (i.e., sharing in a percentage of professional fees). The interpretation and enforcement of these laws vary significantly from state to state. We provide management services to a network of physicians. If our arrangements with this network were deemed to violate state corporate practice of medicine, fee-splitting or similar laws, or if new laws are enacted rendering our arrangements illegal, we may be subject to civil and/or criminal penalties and could be required to restructure or terminate these arrangements, any of which may result in a significant loss of revenue and divert management and business resources.

If regulations change, we may be obligated to purchase some or all of the ownership of our physician partners or renegotiate some of our partnership and operating agreements with our physician partners and management agreements with surgical facilities.

Upon the occurrence of various fundamental regulatory changes or changes in the interpretation of existing regulations, we may be obligated to purchase all of the ownership of the physician investors in most of the partnerships or limited liability companies that own and operate our surgical facilities and/or hospitals. The purchase price that we would be required to pay for the ownership is specified in our partnership agreements and is typically based on either a multiple of the surgical facility's EBITDA, as defined in our partnership and operating agreements with these surgical facilities and hospitals, or the fair market value of the ownership as determined by a third-party appraisal. The physician investors in some of our surgical facilities and hospitals can require us to purchase their interests in exchange for cash or shares of our common stock if these regulatory changes occur. In addition, some of our partnership agreements with our physician partners and management agreements with surgical facilities and hospitals require us to attempt to renegotiate the agreements upon the occurrence of various fundamental regulatory changes or changes in the interpretation of existing regulations and provide for termination of the agreements if renegotiations are not successful.

Regulatory changes that could create purchase or renegotiation obligations include changes that:

- make illegal the referral of Medicare or other patients to our surgical facilities and hospitals by physician investors;

- create a substantial likelihood that cash distributions to physician investors from the partnerships or LLCs through which we operate our surgical facilities and hospitals would be illegal;
- make illegal the ownership by the physician investors of interests in the partnerships or LLCs through which we own and operate our surgical facilities and hospitals; or
- require us to reduce the aggregate percentage of physician investor ownership in our hospitals.

We do not control whether or when any of these regulatory events might occur. In the event we are required to purchase all of the physicians' ownership, our existing capital resources would not be sufficient for us to meet this obligation. These obligations and the possible termination of our partnership and management agreements would have a material adverse effect on our financial condition and results of operations.

Our surgical facilities do not satisfy the requirements for any of the safe harbors under the federal Anti-Kickback Statute. If a federal or state agency asserts a different position or enacts new laws in this regard, we could be subject to criminal and civil penalties, loss of licenses and exclusion from governmental programs, which may result in a substantial loss of revenue.

The Anti-Kickback Statute prohibits the offer, payment, solicitation or receipt of any form of remuneration in return for referrals for items or services payable by Medicare, Medicaid, or any other federally funded health care program. Our exclusion from participation in all federally funded health care programs as a result of a violation of the Anti-Kickback Statute would have a material adverse effect on our business, prospects, results of operations and financial condition. In addition, many of the states in which we operate have also adopted laws, similar to the Anti-Kickback Statute, that prohibit payments to physicians in exchange for referrals, some of which apply regardless of the source of payment for care. These statutes typically impose criminal and civil penalties, including the loss of a license to do business in the state.

The "Investment Interest" safe harbor and the "Personal Services and Management Contracts" safe harbor apply to business arrangements similar to those used in connection with our surgical facilities. However, the structure of the partnerships and limited liability companies operating our surgery centers and surgical hospitals, as well as our various business arrangements involving physician group practices, do not satisfy all of the requirements of either safe harbor. We have entered into management agreements to manage the majority of our surgical facilities. Most of these agreements call for our subsidiary to be paid a percentage-based management fee. Because our management fees are generally based on a percentage of revenue, our management agreements do not typically meet the Personal Services and Management Contracts safe harbor. We have implemented formal compliance programs designed to safeguard against overbilling and believe that our management agreements comply with the requirements of the Anti-Kickback Statute. However, we cannot assure you that the OIG would find our compliance programs to be adequate or that our management agreements would be found to comply with the Anti-Kickback Statute.

The surgery center safe harbor protects four types of investment arrangements: (1) surgeon owned surgery centers; (2) single specialty surgery centers; (3) multi-specialty surgery centers; and (4) hospital/physician surgery centers. In addition to the physician investor, the categories permit an "unrelated" investor, who is a person or entity that is not in a position to provide items or services related to the surgery center or its investors. Our business arrangements with our surgical facilities typically consist of one of our subsidiaries being an investor in each partnership or limited liability company that owns the facility, in addition to providing management and other services to the facility. Therefore, our business arrangements with our surgery centers, surgical hospitals and physician groups do not qualify for the expanded safe harbor protection from government review or prosecution under the Anti-Kickback Statute. However, we believe that we are in compliance with the requirements of the Anti-Kickback Statute.

We employ dedicated marketing personnel whose job functions include the recruitment of physicians to perform surgery at our facilities. These employees are paid a base salary plus a productivity bonus. We believe our employment arrangements with these employees are consistent with a safe harbor provision designed to protect payments made to employees. However, a government agency or private party may assert a contrary position.

We also enter into lease agreements with physicians from time to time for the rental of space for our surgical facilities. We seek to structure these lease agreements so that they are in compliance with the Anti-Kickback Statute safe harbor provision regarding real estate leases. However, a government agency or private party may assert a contrary position.

If any of our business arrangements with physicians or sales and marketing personnel were alleged or deemed to violate the Anti-Kickback Statute or similar laws, or if new federal or state laws were enacted rendering these arrangements illegal, it could have a material adverse effect on our business, prospects, results of operations and financial condition.

In addition to the physician ownership in our surgical facilities, other financial relationships of ours with potential referral sources could potentially be scrutinized under the Anti-Kickback Statute.

Certain of our ASCs have entered into arrangements for professional services, including arrangements for anesthesia services. The OIG scrutinizes certain arrangements it deems to be "suspect Contractual Joint Ventures," including arrangements between anesthesiologists and physician owners of ASCs. We believe our arrangements for anesthesia services are distinguishable from those described in Advisory Opinion 12-06 (May 25, 2012) and are in compliance with the requirements of the federal Anti-Kickback Statute. However, we cannot assure you that regulatory authorities would agree with that position.

The Eliminating Kickbacks in Recovery Act may affect our financial relationships with referral sources utilizing our clinical laboratories

In addition to the Anti-Kickback Statute, the U.S. recently enacted a new law known as the Eliminating Kickbacks in Recovery Act, or the EKRA, discussed in greater detail above. While the EKRA does contain certain exceptions similar to the Anti-Kickback Statute Safe Harbors, those exceptions are more narrow than the Anti-Kickback Statute Safe Harbors. As a result, the operations at our clinical laboratories may be impacted by the EKRA.

If we fail to comply with physician self-referral laws as they are currently interpreted or may be interpreted in the future, or if other legislative restrictions are issued, we could incur substantial monetary penalties and a significant loss of revenue.

The Stark Law prohibits certain self-referrals for health care services unless an exception applies. Under the current Stark Law and related regulations, services provided at an ASC are not covered by the statute, even if those services include imaging, laboratory services or other Stark designated health services, provided that (i) the ASC does not bill for these services separately, or (ii) if the center is permitted to bill separately for these services, they are specifically exempted from Stark Law prohibitions. These are generally radiology and other imaging services integral to performance of surgical procedures that meet certain requirements and certain outpatient prescription drugs. Services provided at our facilities licensed as hospitals are covered by the Stark Law. We attempt to structure our relationship with physicians who refer to our hospitals to meet an exception to the Stark Law where required, but the regulations implementing the exceptions are detailed and complex, and we cannot guarantee that every relationship complies fully with the Stark Law. We also believe that certain services provided by our managed physician network are covered by the Stark Law, but referrals for those services are exempt from the Stark Law under its "in-office ancillary services exception," among others.

Violations of these self-referral laws may result in substantial civil or criminal penalties, including treble damages for amounts improperly claimed, civil monetary penalties of up to \$15,000 per prohibited service billed, up to \$100,000 per prohibited circumvention scheme and exclusion from participation in the Medicare and Medicaid and other federal and state health care programs. Violations of the Stark Law will also create liability under the federal False Claims Act. Exclusion of our ASCs or hospitals from these programs through judicial or agency interpretation of existing laws or additional legislative restrictions on physician ownership or investments in health care entities could result in a significant loss of reimbursement revenue. We cannot provide assurances that CMS will not undertake other rulemaking to address additional revisions to or interpretations of the Stark Law regulations. If future rules modify the provisions of the Stark Law regulations that are applicable to our business, our revenue and profitability could be materially adversely affected and could require us to modify our relationships with our physician and health care system partners.

Federal law restricts the ability of our surgical hospitals to expand surgical capacity.

The Affordable Care Act dramatically curtailed the Whole Hospital Exception and prohibits physician ownership in hospitals that did not have a Medicare provider agreement by December 31, 2010. As a result, the law effectively prevents the formation of new physician-owned hospitals that participate in Medicare and Medicaid after December 31, 2010. Each of our surgical hospitals had a Medicare provider agreement in place prior to December 31, 2010 and is therefore able to continue operating with the ownership structure that was in place prior to December 30, 2010. However, the Affordable Care Act prohibits "grandfathered" hospitals from increasing their percentage of physician ownership, and it limits to a certain extent their ability to grow, because it prohibits such hospitals from increasing the aggregate number of inpatient beds, operating rooms and procedure rooms.

Companies within the health care industry, including us, continue to be the subject of federal and state audits and investigations, including actions for false and other improper claims.

Federal and state government agencies, as well as commercial payors, have increased their auditing and administrative, civil and criminal enforcement efforts as part of numerous ongoing investigations of health care organizations. These audits and investigations relate to a wide variety of topics, including the following: cost reporting and billing practices; quality of care; financial reporting; financial relationships with referral sources; and medical necessity of services provided. In addition, the OIG and the U.S. Department of Justice ("DOJ") have, from time to time, undertaken national enforcement initiatives that focus on specific billing practices or other suspected areas of abuse. In its 2013 Work Plan, the OIG stated its intention to review the safety and quality of care for Medicare beneficiaries having surgeries and procedures in ASCs and hospital outpatient departments.

The federal government may impose criminal, civil and administrative penalties on any person or entity that files a false claim for payment from the Medicare or Medicaid programs and other federal and state health care programs. Claims filed with private insurers can also lead to criminal and civil penalties, including, but not limited to, penalties relating to violations of federal mail and wire fraud statutes, as well as penalties under the anti-fraud provisions of the HIPAA. While the criminal statutes are generally reserved for instances of fraudulent intent, the federal government is applying its criminal, civil and administrative penalty statutes in an ever-expanding range of circumstances, including claiming payment for unnecessary services if the claimant merely should have known the services were unnecessary and claiming payment for low-quality services if the claimant should have known that the care was substandard. In addition, a violation of the Stark Law or the Anti-Kickback Statute can result in liability under the federal False Claims Act (the "FCA").

Over the past several years, the federal government has investigated an increasing number of health care providers for potential FCA violations, which, among other things, prohibits a person from knowingly presenting, or causing to be presented, a false or fraudulent claim to the federal government. The statute defines "knowingly" to include not only actual knowledge of a claim's falsity, but also reckless disregard for or intentional ignorance of the truth or falsity of a claim. Violators of the FCA are subject to severe financial penalties,

including treble damages and per claim penalties in excess of \$10,000. Because our facilities perform hundreds or thousands of similar procedures each year for which they are paid by Medicare, and since the statute of limitations for such claims extends for six years under normal circumstances (and possibly as long as ten years in the event of failure to discover material facts), a repetitive billing error or cost reporting error could result in significant, material repayments and civil or criminal penalties.

Moreover, another trend impacting health care providers is the increased use of the FCA, particularly by individuals who bring actions under that law. Under the "qui tam," or whistleblower, provisions of the FCA, private parties may bring actions on behalf of the federal government. If the government intervenes and prevails in the action, the defendant may be required to pay three times the actual damages sustained by the government, plus mandatory civil monetary penalties of between \$11,665 and \$23,351 for each false claim submitted to the government. These private parties, often referred to as relators, are entitled to share in any amounts recovered by the government through trial or settlement. Both direct enforcement activity by the government and whistleblower lawsuits under the FCA have increased significantly in recent years; thus, the risk that we will have to defend a false claims action, pay significant fines or be excluded from the Medicare and Medicaid programs has increased.

In addition, the Fraud Enforcement and Recovery Act of 2009 ("FERA") further expanded the scope of the FCA to create liability for knowingly and improperly avoiding or decreasing an obligation to pay money to the federal government and FERA, along with statutory provisions found in the Acts, created federal False Claims Act liability for the knowing failure to report and return an overpayment within 60 days of the identification of the overpayment or, in certain cases, the date by which a corresponding cost report is due, whichever is later. Governmental authorities have and may continue to challenge or scrutinize our operations. An allegation or determination that we have violated the law could have a material adverse effect on our business, prospects, results of operations and financial condition.

HIPAA also created new federal criminal statutes that prohibit among other actions, knowingly and willfully executing, or attempting to execute, a scheme to defraud any health care benefit program, including private third-party payors, knowingly and willfully embezzling or stealing from a health care benefit program, willfully obstructing a criminal investigation of a health care offense, and knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for health care benefits, items or services. Similar to the federal Anti-Kickback Statute, a person or entity does not need to have actual knowledge of the statute or specific intent to violate it in order to have committed a violation.

In addition, a person who offers or transfers to a Medicare or Medicaid beneficiary any remuneration, including waivers of copayments and deductible amounts (or any part thereof), that the person knows or should know is likely to influence the beneficiary's selection of a particular provider, practitioner or supplier of Medicare or Medicaid payable items or services may be liable for civil monetary penalties of up to \$11,665 for each wrongful act. Moreover, in certain cases, providers who routinely waive copayments and deductibles for Medicare and Medicaid beneficiaries can also be held liable under the Anti-Kickback Statute and civil False Claims Act, which can impose additional penalties associated with the wrongful act. Although this prohibition applies only to federal health care program beneficiaries, the routine waivers of copayments and deductibles offered to patients covered by commercial payors may implicate applicable state laws related to, among other things, unlawful schemes to defraud, excessive fees for services, tortious interference with patient contracts and statutory or common law fraud. To the extent our patient assistance programs or other discount policies are found to be inconsistent with applicable laws, we may be required to restructure or discontinue such programs, or be subject to other significant penalties.

To enforce compliance with the federal laws, the DOJ has increased its scrutiny of interactions between health care companies and health care providers, which has led to a number of investigations, prosecutions, convictions and settlements in the health care industry. Dealing with investigations can be time and resource consuming and can divert management's attention from the business. In addition, settlements with the DOJ or other law enforcement agencies have forced health care providers to agree to additional compliance and reporting requirements as part of a consent decree or corporate integrity agreement. Any such investigation or settlement could increase our costs or otherwise have an adverse effect on our business.

We are also subject to various state laws and regulations, as well as contractual provisions with commercial payors that prohibit us from submitting inaccurate, incorrect or misleading claims. We cannot be sure that none of our surgical facilities' claims will ever be challenged. If we were found to be in violation of a state's laws or regulations, or of a commercial payor contract, we could be forced to discontinue the violative practice and be subject to recoupment actions, fines and criminal penalties, which could have a material adverse effect on our business, prospects, results of operations and financial condition.

All payors are increasingly conducting post-payment audits. For example, CMS has implemented the RAC program, involving Medicare claims audits nationwide, and employs MICs to perform post-payment audits of Medicaid claims and identify overpayments. In addition to RACs and MICs, the state Medicaid agencies and other contractors have increased their review activities. We are regularly subject to these external audits and we also perform both internal and third-party audits and monitoring.

Although all other repayments requested to date as a result of RAC, MIC and ZPIC audits have not been material to our Company, we are unable to quantify the suspended payments and aggregate financial impact of these audits on our facilities given the pending appeals and uncertainty about the extent of future audits and whether the underlying conduct could be considered systemic. As such, the resolution of these audits could have a material adverse effect on our business, prospects, results of operations and financial condition.

On October 23, 2017, the Company received a series of civil investigative demands ("CIDs") from the federal government under the FCA for documents and information dating back to January 1, 2010 relating to the medical necessity of certain drug tests conducted by the

Company's physicians and submitted to laboratories owned and operated by the Company. In addition, the Company was informed by CMS that payments to its diagnostic laboratory, Logan Laboratories, were suspended for a period of time, pending further investigations by CMS. CMS lifted the suspension as of December 18, 2019. On January 23, 2020, the U.S. District Court for the Middle District of Florida unsealed the Complaint in the case of Cho et al. ex rel. United States v. Surgery Partners et al., which we understand to be related to the investigation that gave rise to the CIDs. On April 14, 2020, the Company entered into a settlement agreement (the "Settlement Agreement") with the United States of America, acting through the DOJ. Under the terms of the Settlement Agreement, the Company still owes payment of \$30.7 million plus accrued interest as of April 1, 2021. For additional information, please refer to Note 14. "Commitments and Contingencies" to our audited financial statements included elsewhere in the report.

We may become involved in litigation which could negatively impact the value of our business.

From time-to-time we are involved in lawsuits, claims, audits and investigations, including those arising out of services provided, personal injury claims, professional liability claims, billing and marketing practices, employment disputes and contractual claims. We may become subject to future lawsuits, claims, audits and investigations that could result in substantial costs and divert our attention and resources and adversely affect our business condition. In addition, since our current growth strategy includes acquisitions, among other things, we may become exposed to legal claims for the activities of an acquired business prior to our acquisition of such business. These lawsuits, claims, audits or investigations, regardless of their merit or outcome, may also adversely affect our reputation and ability to expand our business.

In addition, from time to time we have received, and expect to continue to receive, correspondence from former employees terminated by us who threaten to bring claims against us alleging that we have violated one or more labor and employment regulations. In certain instances former employees have brought claims against us and we expect that we will encounter similar actions against us in the future. An adverse outcome in any such litigation could require us to pay contractual damages, compensatory damages, punitive damages, attorneys' fees and costs.

If we become subject to large malpractice or other legal claims, we could be required to pay significant damages, which may not be covered by insurance.

In recent years, physicians, hospitals and other health care providers have become subject to an increasing number of legal actions alleging malpractice, product liability or related legal theories. Many of these actions involve large monetary claims and significant defense costs. We also owe certain defense and indemnity obligations to our officers and directors.

Our insurance coverage may not cover all claims against us, or insurance coverage may not continue to be available at a cost allowing us to maintain adequate levels of insurance. If one or more successful claims against us were not covered by or exceeded the coverage of our insurance, our financial condition and results of operations could be adversely affected. Our business, profitability and growth prospects could suffer if we face negative publicity or we pay damages or defense costs in connection with a claim that is outside the scope or limits of coverage of any applicable insurance coverage, including claims related to adverse patient events, contractual disputes, professional and general liability, and directors' and officers' duties.

In addition, market rates for insurance premiums and deductibles have been steadily increasing. Our earnings and cash flows could be materially and adversely affected by any of the following:

- the collapse or insolvency of our insurance carriers;
- further increases in premiums and deductibles;
- increases in the number of liability claims against us or the cost of settling or trying cases related to those claims; or
- an inability to obtain one or more types of insurance on acceptable terms, if at all.

Failure to comply with Medicare's conditions for coverage and conditions of participation may result in loss of program payment or other governmental sanctions.

To participate in and receive payment from the Medicare program, our facilities must comply with regulations promulgated by CMS. These regulations, known as "conditions for coverage" for ASCs and "conditions of participation" for hospitals, set forth specific requirements with respect to, among other things, the facility's physical plant, equipment, personnel and standards of medical care. All of our surgery centers and surgical hospitals are certified to participate in the Medicare program. As such, these facilities are subject to on-site, unannounced surveys by state survey agencies working on behalf of CMS, which may lead to deficiency citations requiring remedy with appropriate action plans. Failure to comply with Medicare's conditions for coverage or conditions of participation may result in loss of payment or other governmental sanctions, including termination from participation in the Medicare program. We have established ongoing quality assurance activities to monitor our facilities' compliance with these conditions and respond to surveys, but we cannot be sure that our facilities are or will always remain in full compliance with the requirements. In addition, pending a determination regarding our compliance with these conditions, payment to us may be suspended and we may be required to devote significant time, effort and expense to demonstrate satisfactory compliance.

Our facilities could face decreased Medicare payments if they fail to report and meet various quality metrics.

The Medicare program presently requires hospitals and ASCs to report performance data on a variety of quality metrics. Facilities that fail to report are penalized with reduced Medicare payments. Additionally, payments to hospitals are adjusted based on the hospital's performance on these quality measures. A substantial portion of hospital payment is at risk depending on its individual performance relative to benchmarks and other hospitals' performance. There is a substantial risk that our Medicare payments could be reduced if our hospitals fail to perform adequately on these measures. Additionally, there is a risk that Medicare payments could be reduced if our facilities (hospitals and ASCs) fail to adequately report data as required by CMS. ASC payments are not yet adjusted based on performance against quality measures, but there is a substantial risk that Congress may soon link ASC Medicare payments to actual performance, in addition to reporting.

If the public performance data becomes a primary factor in determining where patients choose to receive care, and if competing hospitals and ASCs have better results than our facilities on those measures, our patient volumes could decline.

State efforts to regulate the construction, acquisition or expansion of health care facilities could prevent us from acquiring additional surgical facilities, renovating our existing facilities or expanding the breadth of services we offer.

Some states require prior approval for the construction, acquisition or expansion of health care facilities or expansion of the services the facilities offer. In giving approval, these states consider the need for additional or expanded health care facilities or services, as well as the financial resources and operational experience of the potential new owners of existing health care facilities. In many of the states in which we currently operate, certificates of need must be obtained for capital expenditures exceeding a prescribed amount, changes in capacity or services offered and various other matters. The remaining states in which we now or may in the future operate may adopt similar legislation. Our costs of obtaining a certificate of need could be significant, and we cannot assure you that we will be able to obtain the certificates of need or other required approvals for additional or expanded surgical facilities or services in the future. In addition, at the time we acquire a surgical facility, we may agree to replace or expand the acquired facility. If we are unable to obtain required approvals, we may not be able to acquire additional surgical facilities, expand health care services we provide at these facilities or replace or expand acquired facilities.

If antitrust enforcement authorities conclude that our market share in any particular market is too concentrated, that our or our health system partners' commercial payor contract negotiating practices are illegal, or that we otherwise violate antitrust laws, we could be subject to enforcement actions that could have a material adverse effect on our business, prospects, results of operations and financial condition.

The federal government and most states have enacted antitrust laws that prohibit certain types of conduct deemed to be anti-competitive. These laws prohibit price fixing, concerted refusal to deal, market monopolization, price discrimination, tying arrangements, acquisitions of competitors and other practices that have, or may have, an adverse effect on competition. Violations of federal or state antitrust laws can result in various sanctions, including criminal and civil penalties. Antitrust enforcement in the health care industry is currently a priority of the Federal Trade Commission (the "FTC"). We believe we are in compliance with federal and state antitrust laws, but courts or regulatory authorities may reach a determination in the future that could have a material adverse effect on our business, prospects, results of operations and financial condition.

Governance Risks

We are a "controlled company" within the meaning of Nasdaq rules and, therefore, we qualify for, and currently rely on, exemptions from certain corporate governance requirements. Our stockholders do not have the same protections afforded to stockholders of companies that are subject to such requirements.

As of December 31, 2020, Bain Capital controlled a majority of the voting power of our outstanding common stock. As a result, we are a "controlled company" within the meaning of the corporate governance standards of Nasdaq. Under these rules, a company of which more than a majority of the voting power is held by an individual, group or another company is a "controlled company" and may elect not to comply with certain corporate governance requirements including:

1. the requirement that a majority of the board of directors consist of independent directors;
2. the requirement that we have a nominating/corporate governance committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities; and
3. the requirement that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities.

As of December 31, 2020, we have availed ourselves of certain of these exemptions. For example, we did not have a majority of independent directors for the entire period covered by this report (and may, in the future, have less than a majority of independent directors) and we do not have a nominating and corporate governance committee. Accordingly, our stockholders will not have the same protections afforded to stockholders of companies that are subject to all of the corporate governance requirements of Nasdaq.

There can be no assurance as to the period of time during which we will remain a "controlled company".

Our controlling stockholder has significant influence over us, including control over decisions that require the approval of stockholders, which could limit our stockholders' ability to influence the outcome of key transactions, including a change of control.

As of the date of this filing we were controlled by Bain Capital, which beneficially owned approximately 60% of our outstanding common stock. For as long as Bain Capital continues to control a majority of the voting power of our common stock, it will be able to direct the election of all of the members of our board of directors and could exercise a controlling influence over our business and affairs, including any determinations with respect to mergers or other business combinations, the acquisition or disposition of assets, the incurrence of indebtedness, the issuance of any additional common stock or other equity securities, the repurchase or redemption of common stock and the payment of dividends. Similarly, Bain Capital will have the power to determine matters submitted to a vote of our stockholders without the consent of our other stockholders, will have the power to prevent a change in our control and could take other actions that might be favorable to it. Even if Bain Capital ceases to beneficially own a majority of the voting power of our common stock, it will continue to be able to strongly influence or effectively control our decisions.

Provisions in the certificate of designation governing our preferred stock and in our charter documents and Delaware law may deter takeover efforts that could be beneficial to stockholder value.

Our certificate of incorporation and by-laws, the certificate of designation governing our preferred stock and Delaware law contain provisions that could make it harder for a third party to acquire us, even if doing so might be beneficial to our stockholders. The provisions in our organizational documents include a classified board of directors and limitations on actions by our stockholders. In addition, our board of directors has the right to issue additional preferred stock without stockholder approval that could be used to dilute a potential hostile acquiror. Our certificate of incorporation also imposes some restrictions on mergers and other business combinations between us and any holder of 15.0% or more of our outstanding common stock other than affiliates of Bain Capital. Finally, our 10% Series A Convertible Perpetual Participating Preferred Stock accrues conversion value for each quarter it is outstanding and is subject, under certain circumstances, to a redemption premium, which could significantly increase the cost to a potential acquirer of buying all of the outstanding securities of the Company. As a result of these features, our stockholders may lose their ability to sell their stock for a price in excess of the prevailing market price, and efforts by stockholders to change the direction or management of the Company may be unsuccessful.

Our amended and restated certificate of incorporation designates courts in the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.

Our amended and restated certificate of incorporation (the "Certificate of Incorporation") provides that, subject to certain exceptions and to the fullest extent permitted by applicable law, the Court of Chancery of the State of Delaware (the "Court of Chancery") will be the sole and exclusive forum for (i) any derivative action or proceeding brought on our behalf, (ii) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, officers or other employees to us or our stockholders, (iii) any action asserting a claim against us arising pursuant to any provision of the General Corporation Law of the State of Delaware, our Certificate of Incorporation or our amended and restated bylaws or (iv) any other action asserting a claim against us that is governed by the internal affairs doctrine (each, a "Covered Proceeding"). In addition, the Certificate of Incorporation states that this exclusive forum provision does not apply to actions in which the Court of Chancery concludes that an indispensable party is not subject to the jurisdiction of the Delaware courts and can be subject to the jurisdiction of another court within the U.S. Our Certificate of Incorporation also provides that if any action, the subject matter of which is a Covered Proceeding, is filed in a court other than the specified Delaware courts without the approval of our board of directors (each, a "Foreign Action"), the claiming party will be deemed to have consented to (i) the personal jurisdiction of the specified Delaware courts in connection with any action brought in any such courts to enforce the exclusive forum provision described above and (ii) having service of process made upon such claiming party in any such enforcement action by service upon such claiming party's counsel in the Foreign Action as agent for such claiming party. It is our current view that in some circumstances, such as in respect of actions arising under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Court of Chancery may decline to exercise jurisdiction over such actions. Under such circumstances, our Certificate of Incorporation holds that such actions may properly be filed in a court other than the Court of Chancery. Any person or entity purchasing or otherwise acquiring any interest in shares of our stock shall be deemed to have notice of and to have consented to these provisions in our Certificate of Incorporation. These provisions may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits against us and our directors, officers and employees.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate headquarters is located in Brentwood, Tennessee, where we currently lease approximately 85,000 square feet of office space pursuant to an agreement with an initial term expiring December 31, 2027. Our surgical facilities typically are located on real estate leased by the partnership or limited liability company that operates the facility. Most of our ASC facilities range in size from 8,000 to 12,000 square feet, and are specifically tailored to meet the needs of physician-partners and their specialties. Of our 127 surgical facilities, 123 utilize leased real property. These leases generally have initial terms of ten years, but range from 2 to 15 years. Most of the leases contain options to extend the lease period for up to ten additional years. We generally guarantee the lease obligations of the partnerships and limited liability companies that own our surgical facilities. We expect to be able to renew or replace a substantial majority of these leases on substantially similar terms as they come due. We believe these spaces are sufficient and adequate for our needs at this time.

Item 3. Legal Proceedings

Stockholder Litigation. On December 4, 2017, a purported Company stockholder filed an action in the Delaware Court of Chancery (the "Delaware Action"). That action is captioned Klein v. H.I.G. Capital, L.L.C., et al., C.A. No. 2017-0862. The plaintiff in the Delaware Action asserted claims against (i) certain current and former members of the Company's Board of Directors (together, the "Directors"); (ii) H.I.G. Capital, LLC and certain of its affiliates (collectively, the "H.I.G. Parties"); and (iii) Bain Capital Private Equity, L.P. and certain of its affiliates (collectively, "Bain Capital" and, together with the Directors and the H.I.G. Parties, the "Defendants"). The plaintiff asserted derivative claims on behalf of the Company, which is a nominal defendant in the Delaware Action, as well as putatively direct claims on behalf of a purported class of Company stockholders. The plaintiff in the Delaware Action asserted that the Defendants breached their fiduciary duties in connection with the transactions in which (i) the Company acquired National Surgical Healthcare; (ii) Bain Capital acquired preferred equity in the Company; and (iii) Bain Capital acquired H.I.G.'s equity stake in the Company, and that, in the alternative, Bain Capital aided and abetted those purported breaches. The plaintiff also asserted an unjust enrichment claim against Bain Capital.

On January 2, 2018, the Defendants moved to dismiss the plaintiff's complaint. On December 19, 2018, the Court of Chancery issued a decision on that motion. Following that decision, all of the Directors have been dismissed from the Delaware Action. The Court did not dismiss the plaintiff's breach of fiduciary duty claim against the H.I.G. Parties or the aiding and abetting claim asserted against Bain Capital. However, the Court dismissed the plaintiff's breach of fiduciary duty and unjust enrichment claims against Bain Capital. In addition, the Court dismissed all of the plaintiff's claims that were asserted on behalf of a putative class of Company stockholders. Accordingly, all of the plaintiff's remaining claims in the Delaware Action are asserted derivatively on the Company's behalf. The plaintiff has continued to pursue those derivative claims, and the parties to the Delaware Action are engaged in discovery.

Other Litigation. In addition, we are, from time to time, subject to claims and suits, or threats of claims or suits, relating to our business, including claims for damages for personal injuries, breach of management contracts and employment related claims. In certain of these actions, plaintiffs request payment for damages, including punitive damages, which may not be covered by insurance or may otherwise have a material adverse effect on our business or results of operations.

See Note 14. "Commitments and Contingencies" for additional information.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information for Common Stock

Our common stock trades under the symbol "SGRY" on the Nasdaq Global Select Market.

Stockholders

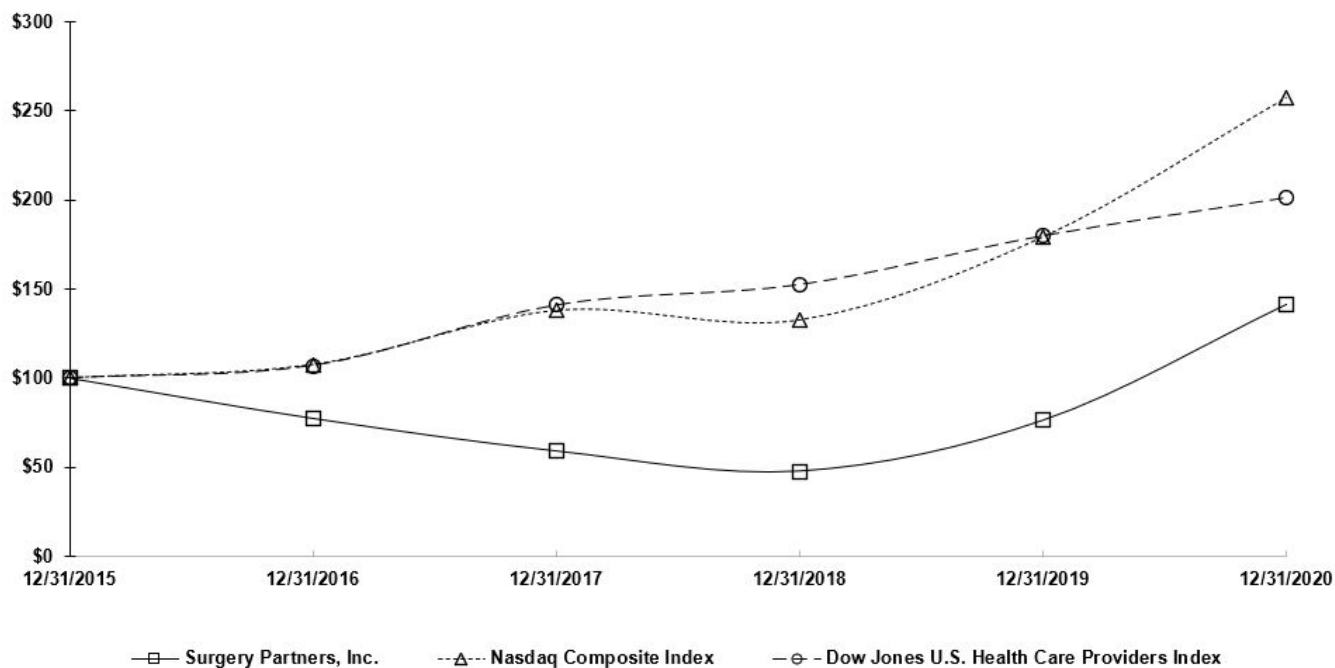
As of March 3, 2021, there were 132 holders of record of our common stock. The actual number of common stockholders is greater than the number of record holders, and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees. This number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

Dividends

We have never declared or paid a cash dividend on our common stock, and have no current plans to declare or pay any cash dividends for the foreseeable future. Any decision to declare and pay dividends in the future will be made at the discretion of our Board of Directors and will depend on, among other things, our results of operations, financial condition, cash requirements, contractual restrictions and other factors that our Board of Directors may deem relevant. In addition, our ability to pay dividends may be limited by covenants of our existing and future outstanding indebtedness we or our subsidiaries incur, including our credit facility. Additionally, because we are a holding company, we would depend on distributions from our subsidiaries to fund any potential dividends.

Stock Performance Graph

The following graph compares the cumulative total shareholder return on our common stock with the cumulative total returns of the Nasdaq Composite Index and the Dow Jones U.S. Health Care Providers Index. The graph begins on December 31, 2015, and the comparison assumes \$100 was invested in our common stock and in each of the indices on such date and assumes the reinvestment of dividends, if any.



	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020
Surgery Partners, Inc.	\$ 100.00	\$ 77.35	\$ 59.05	\$ 47.78	\$ 76.40	\$ 141.58
Nasdaq Composite Index	\$ 100.00	\$ 107.50	\$ 137.86	\$ 132.51	\$ 179.19	\$ 257.38
Dow Jones U.S. Health Care Providers Index	\$ 100.00	\$ 107.04	\$ 141.13	\$ 152.58	\$ 180.13	\$ 201.63

This graph is furnished and not filed with the SEC, is not soliciting material under the Exchange Act and shall not be incorporated by reference into any such filings, irrespective of any general incorporation contained in such filing. The stock performance shown on the graph represents historical stock performance and is not necessarily indicative of future stock price performance.

Recent Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On December 15, 2017, our Board of Directors authorized a share repurchase program of up to \$50.0 million of our issued and outstanding common stock from time to time. The timing and size of repurchases will be determined based on market conditions and other factors. The authorization does not obligate us to repurchase any shares and we may repurchase shares of common stock at any time without prior notice. The share repurchases will be made in accordance with applicable securities laws in open market or privately negotiated transactions. The authorization does not have a specified expiration date, and the share repurchase program may be suspended, recommenced or discontinued at any time or from time to time without prior notice.

The following table presents information related to our repurchases of common stock for the periods indicated:

	Total Number of Shares Purchased ⁽¹⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
<i>(dollars in millions, except per share amounts)</i>				
October 1, 2020 to October 31, 2020	—	\$ —	—	\$ 46.0
November 1, 2020 to November 30, 2020	—	\$ —	—	\$ 46.0
December 1, 2020 to December 31, 2020	17,534	\$ 28.98	—	\$ 46.0
Total	<u>17,534</u>	<u>\$ 28.98</u>	<u>—</u>	<u>\$ 46.0</u>

(1) Shares delivered to or withheld by us in connection with employee payroll tax withholding upon exercise or vesting of stock awards.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and related notes included elsewhere in this Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. For additional information regarding certain of the risks and uncertainties that affect our business and the industry in which we operate, please see Item 1A. "Risk Factors" and Item 9A. "Controls and Procedures" found elsewhere in this report. Unless the context otherwise indicates, the terms "Surgery Partners," "we," "us," "our" or the "Company," as used herein, refer to Surgery Partners, Inc. and its subsidiaries. Unless the context implies otherwise, the term "affiliates" means direct and indirect subsidiaries of Surgery Partners, Inc., and partnerships and joint ventures in which such subsidiaries are partners. The terms "facilities" or "hospitals" refer to entities owned and operated by affiliates of Surgery Partners, Inc. and the term "employees" refers to employees of affiliates of Surgery Partners, Inc.

Executive Overview

As of December 31, 2020, we owned or operated, primarily in partnership with physicians, a portfolio of 127 surgical facilities comprised of 110 ASCs and 17 surgical hospitals across 30 states. We owned a majority interest in 84 of the surgical facilities and consolidated 107 of these facilities for financial reporting purposes.

Total revenues for 2020 increased 1.6% to \$1.9 billion from \$1.8 billion in 2019. Same-facility revenues for 2020 decreased 1.1% from 2019, with a 14.1% increase in revenue per case and a 13.3% decrease in same-facility cases. The decrease in same-facility cases is attributable to the impacts of the COVID-19 pandemic that the Company began experiencing in mid-March, and extending into the fourth quarter. Same-facility revenue per case growth was driven by a favorable surgical case mix as we experienced a faster recovery of higher acuity cases as states began to re-open and allow for non-emergent procedures. For 2020, the net loss attributable to common stockholders was \$155.6 million compared to \$110.5 million for 2019. Additionally, for 2020, Adjusted EBITDA decreased 0.8% to \$256.6 million compared to \$258.6 million for 2019. A reconciliation of non-GAAP financial measures appears below under "Certain Non-GAAP Measures."

We continue to focus on improving our same-facility performance, selectively acquiring established facilities and developing new facilities. During the year ended December 31, 2020, we acquired a controlling interest in three surgical facilities, including a surgical hospital, a controlling interest in five surgical facilities in existing markets, that were merged into existing facilities and a physician practice for total aggregate consideration of \$120.1 million, including cash consideration of \$104.6 million, net of cash acquired, non-cash consideration of \$8.7 million and contingent consideration of \$0.7 million. The non-cash consideration consisted of non-controlling interests in the Company's existing surgical facilities. The cash consideration was funded through cash from operations, proceeds from our recent divestitures and other available resources.

During 2020, we sold our interests in three surgery centers, one of which was previously accounted for as an equity method investment, sold certain assets related to our anesthesia business, certain imaging assets and our optical products purchasing organization for combined net cash proceeds of \$59.0 million. Additionally, we closed our diagnostic laboratory in 2020.

We had cash and cash equivalents of \$317.9 million and \$112.5 million of borrowing capacity under our revolving credit facility at December 31, 2020. Operating cash flows were \$246.9 million in 2020, an increase of \$117.4 million compared to the prior year, primarily attributable to Medicare accelerated payments and other funds received under the CARES Act as well as actions taken to significantly reduce operating expenses and defer non-essential capital expenditures at the height of the crisis. Net operating cash inflows, including operating cash flows less distributions to non-controlling interests, were \$137.3 million for 2020.

Impact of COVID-19

The COVID-19 global pandemic has significantly affected our facilities, employees, patients, communities, business operations and financial performance, as well as the U.S. economy and financial markets. The COVID-19 pandemic materially impacted our financial performance for the year ending December 31, 2020. The length and severity of the pandemic continues to be difficult to predict and is dependent on factors beyond our control.

We continue to take or support measures to try to slow the spread and minimize the impact of the virus. Beginning mid-March, the COVID-19 pandemic began to negatively affect our net revenue and business operations. Due in part to local, state and federal guidelines as well as recommendations from major medical societies regarding social distancing and self-quarantines in response to the COVID-19 pandemic, we cancelled or postponed a substantial percentage of the elective procedures scheduled at our facilities and reduced operating hours at a significant number of our facilities. As a result, surgical case volumes across most of our surgical facilities were significantly impacted in the second quarter of 2020. The impact of the COVID-19 pandemic on our surgical facilities varies based on the market in which the facility operates, the type of surgical facility and the procedures typically performed. Although we cannot provide any certainty regarding the length and severity of the impact of the COVID-19 pandemic, surgical case volumes improved in the second half of 2020 as states began to re-open and allow for non-emergent procedures.

Our operating structure naturally enables some flexibility in the cost structure according to the volume of surgical procedures performed, including much of its cost of revenues. In addition to the natural variability of these costs, the Company and its partners in the surgical facilities have undertaken additional steps to preserve financial flexibility. Beginning in mid-March, and into the second and third quarters, we took actions that included significantly reducing cash operating expenses and deferring non-essential expenditures at the height of the crisis. These measures were gradually reduced as surgical case volumes improved. On April 22, 2020, we entered into a second incremental term loan amendment providing for an incremental borrowing of \$120.0 million, and on July 30, 2020, we issued an additional \$115.0 million aggregate principal amount of 10.000% senior unsecured notes due 2027. See Note 5. "Long-Term Debt" to our consolidated financial statements included elsewhere in this report for a further discussion of the second incremental term loan amendment and the senior unsecured notes. Additionally, as a result of the CARES Act and other governmental assistance programs, during the year ended December 31, 2020, the Company received approximately \$59 million in direct grant funding and approximately \$120 million in accelerated Medicare payments, each of which is described in more detail in Note 1. "Organization and Summary of Accounting Policies - COVID-19 Pandemic" to our consolidated financial statements included elsewhere in this report.

Even after taking into account our actions intended to increase financial flexibility (including actions that management estimates have lowered cash operating expenses), the volume reductions resulted in materially higher losses and material decreases in Adjusted EBITDA during 2020, and may potentially continue to do so for subsequent quarters. We cannot predict if or when utilization may return to pre-pandemic levels.

The Company is continuing to monitor legislative actions at federal and state levels, including the impact of the CARES Act and other governmental assistance that might be available.

Furthermore, please see "Capital Resources" and "Summary" under the heading "Liquidity and Capital Resources" below for more information about the impact of the COVID-19 pandemic on the Company.

Revenues

Our revenues consist of patient service revenues and other service revenues. Patient service revenues consist of revenue from our Surgical Facility Services and Ancillary Services segments. Specifically, patient service revenues include fees for surgical or diagnostic procedures performed at surgical facilities that we consolidate for financial reporting purposes, as well as for patient visits to our physician practices, anesthesia services, pharmacy services and diagnostic screens ordered by our physicians. Other service revenues include management and administrative service fees derived from our non-consolidated facilities that we account for under the equity method, management of surgical facilities and physician practices in which we do not own an interest and management services we provide to physician practices for which we are not required to provide capital or additional assets.

The following table summarizes revenues by service type as a percentage of total revenues:

	Year Ended December 31,		
	2020	2019	2018
Patient service revenues:			
Surgical facilities revenues	95.3 %	94.1 %	93.6 %
Ancillary services revenues	3.4 %	4.3 %	4.5 %
	98.7 %	98.4 %	98.1 %
Other service revenues:			
Optical services revenues	0.2 %	0.2 %	0.5 %
Other	1.1 %	1.4 %	1.4 %
	1.3 %	1.6 %	1.9 %
Total revenues	100.0 %	100.0 %	100.0 %

Payor Mix

The following table sets forth by type of payor the percentage of our patient service revenues generated at the surgical facilities that we consolidate for financial reporting purposes:

	Year Ended December 31,		
	2020	2019	2018
Private insurance payors	53.9 %	53.8 %	54.6 %
Government payors	38.6 %	38.9 %	37.6 %
Self-pay payors	3.2 %	2.6 %	2.9 %
Other payors ⁽¹⁾	4.3 %	4.7 %	4.9 %
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

(1) Other is comprised of anesthesia service agreements, auto liability, letters of protection and other payor types.

Surgical Case Mix

We primarily operate multi-specialty surgical facilities where physicians perform a variety of procedures in various specialties. We believe this diversification helps to protect us from adverse pricing and utilization trends in any individual procedure type and results in greater consistency in our case volume.

The following table sets forth the percentage of cases in each specialty performed at the surgical facilities that we consolidate for financial reporting purposes:

	Year Ended December 31,		
	2020	2019	2018
Orthopedics and pain management	39.3 %	38.3 %	37.8 %
Ophthalmology	25.3 %	24.8 %	25.3 %
Gastrointestinal	19.4 %	20.9 %	21.4 %
General surgery	3.1 %	3.2 %	3.0 %
Other	12.9 %	12.8 %	12.5 %
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

Segment Information

Our business is comprised of three segments: (1) Surgical Facility Services, (2) Ancillary Services and (3) Optical Services. On December 31, 2020, we sold the remaining assets of the Optical Services segment. For more information about the components of each segment, please see Part I, Item 1. Business--Operations included elsewhere in this Annual Report. "All other" primarily consists of the Company's corporate general and administrative functions.

The following tables present financial information for each reportable segment (in millions):

	Year Ended December 31,		
	2020	2019	2018
Revenues:			
Surgical Facility Services	\$ 1,793.4	\$ 1,748.2	\$ 1,682.4
Ancillary Services	63.6	79.4	79.6
Optical Services	3.1	3.8	9.5
Total revenues	<u>\$ 1,860.1</u>	<u>\$ 1,831.4</u>	<u>\$ 1,771.5</u>
Adjusted EBITDA:			
Surgical Facility Services	\$ 339.3	\$ 328.9	\$ 309.5
Ancillary Services	(3.4)	2.6	3.0
Optical Services	1.4	1.4	2.5
All other	(80.7)	(74.3)	(80.2)
Total Adjusted EBITDA ⁽¹⁾	<u>\$ 256.6</u>	<u>\$ 258.6</u>	<u>\$ 234.8</u>
Supplemental Information:			
Cash purchases of property and equipment, net:			
Surgical Facility Services	\$ 38.7	\$ 65.9	\$ 34.2
Ancillary Services	0.4	1.1	0.4
All other	3.8	6.6	5.2
Total cash purchases of property and equipment, net	<u>\$ 42.9</u>	<u>\$ 73.6</u>	<u>\$ 39.8</u>

(1) For a reconciliation of Adjusted EBITDA to income before income taxes as reflected in the audited consolidated statements of operations see "Certain Non-GAAP Measures" below.

	December 31,	
	2020	2019
Assets:		
Surgical Facility Services	\$ 4,962.4	\$ 4,580.4
Ancillary Services	35.0	69.6
Optical Services	—	17.7
All other	415.8	351.2
Total assets	<u>\$ 5,413.2</u>	<u>\$ 5,018.9</u>

Critical Accounting Policies

In preparing our consolidated financial statements in conformity with U.S. Generally Accepted Accounting Principles ("GAAP"), we must use estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures and the reported amounts of revenue and expenses. In general, our estimates are based on historical experience and various other assumptions we believe are reasonable under the circumstances. We evaluate our estimates on an ongoing basis and make changes to the estimates and related disclosures as experience develops or new information becomes known. Actual results could differ from those estimates.

We consider our critical accounting policies to be those that involve significant judgments and uncertainties, and may potentially result in materially different results under different assumptions and conditions.

Revenue Recognition

Our patient service revenues are derived primarily from surgical procedures performed at our ASCs and surgical hospitals, patient visits to physician practices, anesthesia services provided to patients, pharmacy services and diagnostic screens ordered by our physicians. The fees for such services are billed either to the patient or a third-party payor, including Medicare and Medicaid. We recognize patient service revenues, net of contractual allowances, which we estimate based on existing contracts or the historical trend of our cash collections and contractual write-offs.

Prior to its sale on December 31, 2020, our optical products purchasing organization negotiated volume buying discounts with optical product manufacturers. The buying discounts and any handling charges billed to the members of the purchasing organization represented the revenues recognized for financial reporting purposes. Revenue is recognized as orders are shipped to members.

Other service revenues consist of management and administrative service fees derived from non-consolidated surgical facilities that we account for under the equity method, management of surgical facilities in which we do not own an interest and management services we provide to physician networks for which we are not required to provide capital or additional assets. The fees we derive from these management arrangements are based on a predetermined percentage of the revenues of each surgical facility and physician network. We recognize other service revenues in the period in which services are rendered.

Accounts Receivable

Our patient service revenues and other receivables from third-party payors are recorded net of estimated implicit price concessions which are estimated based on the historical trend of our surgical hospitals' cash collections and contractual write-offs, and for our surgical facilities in general, established fee schedules, relationships with payors and procedure statistics. While changes in estimated reimbursement from third-party payors remain a possibility, we expect that any such changes would be minimal and, therefore, would not have a material effect on our financial condition or results of operations.

Our collection policies and procedures are based on the type of payor, size of claim and estimated collection percentage for each patient account. The operating systems used to manage our patient accounts provide for an aging schedule in 30-day increments, by payor, physician and patient. We analyze accounts receivable at each of our surgical facilities to ensure the proper collection and aged category. The operating systems generate reports that assist in the collection efforts by prioritizing patient accounts. Collection efforts include direct contact with insurance carriers or patients, written correspondence and the use of legal or collection agency assistance, as required. Our days sales outstanding was 69 days for the year ended December 31, 2020 and 64 days for the year ended December 31, 2019.

We recognize that final reimbursement of outstanding accounts receivable is subject to final approval by each third-party payor. However, because we have contracts with our third-party payors and we verify the insurance coverage of the patient before services are rendered, the amounts that are pending approval from third-party payors are minimal. Amounts are classified outside of self-pay if we have an agreement with the third-party payor or we have verified a patient's coverage prior to services rendered. It is our policy to collect co-payments and deductibles prior to providing services, where possible. It is also our policy to verify a patient's insurance 72 hours prior to the patient's procedure. Because our services are primarily non-emergency, our surgical facilities have the ability to control these procedures.

Income Taxes

We use the asset and liability method to account for income taxes. Under this method, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If a NOL and/or interest limitation ("163(j)") carryforward exists, we make a determination as to whether that NOL and/or 163(j) carryforward will be utilized in the future. A valuation allowance will be established for certain NOL and 163(j) carryforwards and other deferred tax assets where their recoverability is deemed to be uncertain. The carrying value of the net deferred tax assets is based upon estimates and assumptions related to our ability to generate sufficient future taxable income in certain tax jurisdictions. If these estimates and related assumptions change in the future, we will be required to adjust our deferred tax valuation allowances.

As of December 31, 2020, we had unused federal NOL carryforwards of approximately \$615.7 million. Such losses expire in various amounts at varying times beginning in 2026. Unless they expire, these NOL carryforwards may be used to offset future taxable income and thereby reduce our income taxes otherwise payable.

We recorded a valuation allowance against our deferred tax assets at December 31, 2020 and 2019 totaling \$91.1 million and \$77.9 million, respectively. The valuation allowance has been established for certain deferred tax assets for which we believe it is more likely than not that the tax benefits will not be realized, which are primarily Section 163(j) interest carryforwards, certain state net operating losses and capital loss carryforwards. If our expectations for future operating results on a consolidated basis or at the state jurisdiction level vary from actual results due to changes in health care regulations, general economic conditions, or other factors, we may need to adjust the valuation allowance, for all or a portion of our deferred tax assets. Our income tax expense in future periods will be reduced or increased to the extent of offsetting decreases or increases, respectively, in our valuation allowance in the period when the change in circumstances occurs. These changes could have a significant impact on our future earnings.

Section 382 of the Internal Revenue Code of 1986 ("Section 382"), as amended (the "Code") imposes an annual limit on the ability of a corporation that undergoes an "ownership change" to use its NOLs to reduce its tax liability. An "ownership change" is generally defined as any change in ownership of more than 50.0% of a corporation's "stock" by its "5-percent shareholders" (as defined in Section 382) over a rolling three-year period based upon each of those shareholder's lowest percentage of stock owned during such period. As a result of the Symbion acquisition in 2014, approximately \$179 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$4.9 million, and, as a result of the NovaMed acquisition in 2011, approximately \$17 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$4.9 million. As a result of the acquisition of NSH, approximately \$20.5 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$2.8 million. The Private Sale resulted in an ownership change as defined in Section 382. As a result, approximately \$485.9 million in NOL carryforwards are subject to an annual Section 382 base limitation of \$14.2 million. At this time, we do not believe this limitation, when combined with amounts allowable due to net unrecognized built in gains, will affect our ability to use any NOLs before they expire. However, no such assurances can be provided. If our ability to utilize our NOLs to offset taxable income generated in the future is subject to this limitation, it could have an adverse effect on our business, prospects, results of operations and financial condition.

Impairment of Goodwill

Goodwill represents the excess of the fair value of the consideration conveyed in the acquisition over the fair value of net assets acquired. Goodwill is reviewed for impairment at the reporting unit level, which is defined as one level below an operating segment, on an annual basis or sooner if the indicators of impairment arise. Our judgments regarding the existence of impairment indicators are based on market conditions and operational performance of each reporting unit. During 2020, the Company had identified three reporting units, which include the following: 1) Surgical Facilities, 2) Ancillary Services, and 3) Alliance, which is a component of the Optical Services operating segment.

The Company tests its goodwill and indefinite-lived intangible assets for impairment at least annually, as of October 1, or more frequently if certain indicators arise. A detailed evaluation of potential impairment indicators was performed, which specifically considered the volatility observed in the prices of the Company's outstanding debt securities and common stock, as well as the decline in surgical case volumes following the emergence of the COVID-19 pandemic, all of which improved in the second half of 2020 as states began to re-open and allow for non-emergent procedures.

On the basis of available evidence as of August 31, 2020, we identified indicators of impairment related to the Ancillary Services and Alliance reporting units, including the impacts of the COVID-19 pandemic and the closure of our diagnostic laboratory. No indicators of impairment were identified for the Surgical Facilities reporting unit. Based on the impairment indicators noted, we performed an impairment analysis for the Ancillary Services and Alliance reporting units as of August 31, 2020. As of the August 31, 2020 valuation, the carrying value for both the Ancillary Services and Alliance reporting units exceeded the fair value, resulting in non-cash impairment charges of \$28.6 million and \$4.9 million, respectively.

As of October 1, 2020, prior to its annual impairment testing, the Company's three reporting units with allocated goodwill were as follows: 1) Surgical Facilities - \$3.3 billion, 2) Ancillary Services - no remaining goodwill after the August 31 impairment discussed above, and 3) Alliance - \$4.2 million. As of the October 1, 2020 valuation, the fair value for the Surgical Facilities reporting unit was substantially in excess of its carrying value, and there were no additional indicators of impairment related to the other reporting units.

Subsequent to the date of our annual impairment test, the Company considered its operating results for the fourth quarter of 2020, macroeconomic, industry and market conditions, and other market indicators including its market capitalization. Based on its evaluation of all such factors, the Company concluded that an event had not occurred or circumstances had not changed that would more likely than not reduce the fair value of its reporting units below their carrying values. On December 31, 2020, the Company disposed of the Alliance reporting unit with the sale of its optical products purchasing organization.

During the year ended December 31, 2019, as a result of its impairment testing, the Company recorded non-cash impairment charges of \$2.5 million related to the Alliance reporting unit. During the year ended December 31, 2018, as a result of its impairment testing, the Company recorded non-cash impairment charges of \$60.7 million and \$13.7 million related to the Ancillary Services and Alliance reporting units, respectively.

See Note 4. "Goodwill and Intangible Assets" to the consolidated financial statements elsewhere in this Annual Report for additional disclosure related to goodwill.

Results of Operations

The following tables summarize certain results from the statements of operations for the periods indicated (dollars in millions):

	Year Ended December 31,		
	2020	2019	2018
Revenues	\$ 1,860.1	\$ 1,831.4	\$ 1,771.5
Operating expenses:			
Cost of revenues	1,480.3	1,407.6	1,361.4
General and administrative expenses	97.1	88.6	93.6
Depreciation and amortization	94.8	76.5	67.4
Income from equity investments	(10.8)	(10.2)	(8.9)
Loss (gain) on disposals and deconsolidations, net	5.7	(4.4)	31.8
Transaction and integration costs	23.2	19.0	31.7
Impairment charges	33.5	7.9	74.4
Grant funds	(46.2)	—	—
Loss on debt extinguishment	—	11.7	—
Litigation settlement	1.2	0.2	46.0
Other income	(1.7)	(1.4)	(3.7)
Total operating expenses	1,677.1	1,595.5	1,693.7
Operating income	183.0	235.9	77.8
Tax receivable agreement expense	—	(2.4)	—
Interest expense, net	(201.8)	(178.9)	(147.0)
(Loss) income before income taxes	(18.8)	54.6	(69.2)
Income tax (benefit) expense	(20.1)	9.5	26.4
Net income (loss)	1.3	45.1	(95.6)
Less: Net income attributable to non-controlling interests	(117.4)	(119.9)	(110.1)
Net loss attributable to Surgery Partners, Inc.	\$ (116.1)	\$ (74.8)	\$ (205.7)

Year Ended December 31, 2020 Compared to Year Ended December 31, 2019

Overview. During 2020, our revenues increased 1.6% to \$1.9 billion from \$1.8 billion in 2019. We incurred net loss attributable to Surgery Partners, Inc. in 2020 of \$116.1 million, compared to net loss of \$74.8 million in 2019, primarily attributable to the impairment charges taken during 2020 and the continued impact of the COVID-19 pandemic on surgical case volumes.

Revenues. Revenues for 2020 and 2019 were as follows (dollars in millions):

	Year Ended December 31,	
	2020	2019
Patient service revenues	\$ 1,836.1	\$ 1,803.1
Optical service revenues	3.0	3.8
Other service revenues	21.0	24.5
Total revenues	\$ 1,860.1	\$ 1,831.4

Patient service revenues increased 1.8% to \$1.84 billion in 2020 compared to \$1.80 billion in 2019. The increase in patient service revenues was primarily attributable to a de novo hospital completed in 2019 and acquisitions completed in 2020 and 2019. Same-facility revenues for 2020 decreased 1.1% from 2019, with a 14.1% increase in same-facility revenue per case, and a 13.3% decrease in the same-facility case volume primarily due to the impacts of the COVID-19 pandemic. Same-facility revenue per case growth was driven by a favorable surgical case mix as higher acuity cases were some of the first to recover when elective procedures returned in the second quarter of 2020.

Cost of Revenues. Cost of revenues were \$1.5 billion in 2020 compared to \$1.4 billion in 2019. The increase in costs was primarily attributable to a de novo hospital completed in 2019, acquisitions completed in 2020 and 2019 and an increase in supply costs associated with higher acuity surgical case volumes. As a percentage of revenues, cost of revenues was 79.6% and 76.9% for 2020 and 2019, respectively. The increase as a percentage of revenues is primarily the result of the decreased revenues in 2020 driven by the decline in surgical case volume that began in mid-March due to the COVID-19 pandemic.

General and Administrative Expenses. General and administrative expenses were \$97.1 million and \$88.6 million in 2020 and 2019, respectively. As a percentage of revenues, general and administrative expenses were 5.2% in 2020 compared to 4.8% in 2019. The increase as a percentage of revenues is primarily the result of the decreased revenues driven by the decline in surgical case volume that began in mid-March due to the COVID-19 pandemic.

Depreciation and Amortization. Depreciation and amortization was \$94.8 million and \$76.5 million in 2020 and 2019, respectively. The increase is primarily due to increased capital investments and integration of a de novo hospital completed in 2019 as well as acquisitions completed in 2020 and 2019. As a percentage of revenues, depreciation and amortization expenses were 5.1% in 2020 and 4.2% in 2019.

Income from Equity Investments. Income from equity investments was \$10.8 million and \$10.2 million in 2020 and 2019, respectively. As a percentage of revenues, income from equity investments was 0.6% for both 2020 and 2019.

Loss (gain) on Disposals and Deconsolidations, Net. The net loss on disposals and deconsolidations was \$5.7 million in 2020, including a \$2.5 million net gain on the sale of three surgical facilities, certain assets related to its anesthesia business, certain imaging assets, its optical products purchasing organization and the closure of a diagnostic laboratory and \$8.2 million primarily related to disposals of other long-lived assets. The net gain on disposals and deconsolidations was \$4.4 million in 2019, including a \$10.9 million gain on the sale of previously owned real property associated with one of our non-consolidated surgical facility equity method investments, offset by a loss of \$6.5 million of disposals of other long-lived assets.

Transaction and Integration Costs. We incurred \$23.2 million of transaction and integration costs in 2020 compared to \$19.0 million in 2019. The increase primarily relates to costs for ongoing development initiatives, divestitures completed in 2020 and the integration of acquisitions we completed in 2020 and 2019.

Impairment Charges. In 2020 we recorded non-cash impairment charges of \$28.6 million and \$4.9 million for goodwill assigned to the Ancillary Services and Alliance reporting units, respectively. See Note 4. "Goodwill and Intangibles" to our consolidated financial statements included elsewhere in this report for further discussion. In 2019 we recorded non-cash impairment charges of \$2.5 million for goodwill assigned to the Alliance reporting unit and \$5.4 million related to a management rights agreement intangible asset. The impairment of the management rights agreement is related to our 2019 acquisition of a clinic that we previously managed. As a result of the transaction, we determined the management rights agreement related to the acquired clinic no longer provided a future benefit.

Grant Funds. We recognized \$46.2 million in grant funds in 2020. The funds were received based on relief available to eligible health care providers under the provisions of the CARES Act, which is described in further detail above in the section titled "Impact of COVID-19" and in Note 1. "Organization and Summary of Accounting Policies - COVID-19 Pandemic" to our consolidated financial statements included elsewhere in this report. There were no grant funds received in 2019.

Loss on Debt Extinguishment. In 2019, we incurred a debt extinguishment loss of \$11.7 million in connection with issuance of the 2027 Unsecured Notes, effective April 11, 2019. The loss includes the redemption premium paid to redeem the 2021 Unsecured Notes partially offset by the write-off of the unamortized fair value premium as of the redemption date.

Litigation Settlement. We incurred a loss in the amount of \$1.2 million and \$0.2 million in 2020 and 2019, respectively, related to the potential resolution of the government investigation discussed in Note 14. "Commitments and Contingencies" to our consolidated financial statements included elsewhere in this report.

Interest Expense, Net. Interest expense, net, was \$201.8 million in 2020 compared to \$178.9 million in 2019. The increase primarily relates to the issuance of the 2027 Unsecured Notes effective April 11, 2019, the 2020 Incremental Term Loans, which were fully drawn on April 22, 2020, the issuance of additional 2027 Unsecured Notes in the amount of \$115.0 million effective July 30, 2020 as well as interest on the Revolver during the period it was fully drawn. As a percentage of revenues, interest expense, net was 10.8% in 2020 compared to 9.8% in 2019.

Income Tax (Benefit) Expense. The income tax benefit was \$20.1 million and income tax expense was \$9.5 million in 2020 and 2019, respectively. The effective tax rate was 106.9% for 2020 compared to 17.4% in 2019. New reconciling items in the 2020 effective tax rate include (i) the release of federal and state valuation allowances on the Company's Internal Revenue Code Section 163(j) interest carryforwards as a result of the increase in deductible interest expense allowed under the CARES Act; (ii) the release of federal and state valuation allowances on the Company's deferred tax assets related to debt financing costs as a result of the finalization of the Internal Revenue Code Section 163(j) interest regulations, for which the deductions of such debt financing costs that are incurred in years 2021 and forward are not considered interest expense for income tax purposes; and (iii) the Settlement Agreement, as discussed in Note 14. "Commitments and Contingencies" to our consolidated financial statements included elsewhere in this Annual Report, which provided that a portion of the final settlement amount was "restitution" for income tax purposes.

Net Income Attributable to Non-Controlling Interests. Net income attributable to non-controlling interests was \$117.4 million and \$119.9 million in 2020 and 2019, respectively. As a percentage of revenues, net income attributable to non-controlling interests was 6.3% in the 2020 period and 6.5% for the 2019 period.

Year Ended December 31, 2019 Compared to Year Ended December 31, 2018

Our discussion regarding the comparison of the year ended December 31, 2019 compared to the year ended December 31, 2018 was previously disclosed beginning on page 46 in our Annual Report on Form 10-K for the year ended December 31, 2019, which was filed on March 13, 2020, under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations - *Year Ended December 31, 2019 Compared to Year Ended December 31, 2018*" and is hereby incorporated herein by reference.

Liquidity and Capital Resources

Operating Activities

The primary source of our operating cash flow is the collection of accounts receivable from federal and state agencies (under the Medicare and Medicaid programs), private insurance companies and individuals. Cash flow provided by operating activities was \$246.9 million and \$129.5 million in 2020 and 2019, respectively. The increase in operating cash flow in 2020 is primarily attributable to Medicare accelerated payments and other funds received under the CARES Act, discussed further below under the heading "Capital Resources," as well as actions taken to significantly reduce operating expenses and defer non-essential capital expenditures at the height of the crisis.

Investing Activities

Net cash used in investing activities in 2020 was \$88.4 million, which included \$42.9 million related to purchases of property and equipment. We paid \$104.6 million, in cash for acquisitions (net of cash acquired), which included a controlling interest in three surgical facilities, including a surgical hospital, a controlling interest in five surgical facilities in existing markets, that were merged into existing facilities and a physician practice. Additionally, we received cash proceeds of \$58.5 million related to the sale of interests in three surgery centers, certain assets related to our anesthesia business, certain imaging assets and an optical products purchasing organization.

Net cash used in investing activities in 2019 was \$85.2 million, which included \$73.6 million related to purchases of property and equipment. We paid \$13.8 million, in cash for acquisitions (net of cash acquired), which primarily included a surgical facility, a clinic that was merged into an existing facility and a physician practice. Further, we paid \$15.2 million in cash for a non-controlling interest in four surgical facilities accounted for as equity method investments and we received cash proceeds of \$17.6 million related to the sale of previously owned real property associated with one of our non-consolidated equity method investments.

Financing Activities

Net cash provided by financing activities in 2020 was \$66.7 million. During the year, we made distributions to non-controlling interest holders of \$109.6 million and payments related to ownership transactions with consolidated affiliates of \$27.4 million. Further, we made repayments on our long-term debt of \$216.3 million, which was offset by borrowings of \$429.4 million. In connection with the 2020 Incremental Term Loans, which were fully drawn on April 22, 2020, and the issuance of additional 2027 Unsecured Notes in the amount of \$115.0 million effective July 30, 2020, we paid debt issuance costs of \$8.5 million.

Net cash used in financing activities in 2019 was \$135.9 million. During this period, we made distributions to non-controlling interest holders of \$121.2 million and payments related to ownership transactions with consolidated affiliates of \$3.2 million. Further, we made repayments on our long-term debt of \$490.8 million, which was offset by borrowings of \$506.9 million. In connection with the issuance of the 2027 Unsecured Notes and redemption of the then existing 2021 Unsecured Notes, we paid debt issuance costs of \$8.9 million and paid a redemption premium of \$17.8 million.

Discussion of the operating, investing and financing activities for the year ended December 31, 2018 was previously disclosed beginning on page 47 in our Annual Report on Form 10-K for the year ended December 31, 2019, which was filed on March 13, 2020, under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" and is hereby incorporated herein by reference.

Long-Term Debt

As of December 31, 2020, the carrying value of our total indebtedness, including finance leases, was \$2.857 billion, which includes unamortized fair value discount of \$3.7 million and unamortized deferred financing costs of \$16.3 million.

Term Loan and Revolving Credit Facility

As of December 31, 2020, we had term loan borrowings with a carrying value of \$1.539 billion, consisting of outstanding aggregate principal of \$1.543 billion and unamortized fair value discount of \$3.7 million (the "Term Loan"). The Term Loan matures on August 31, 2024. The Term Loan amortizes in equal quarterly installments of 0.25% of the aggregate original principal amount of the Term Loan.

We have a revolving credit facility providing for revolving borrowings of up to \$120.0 million (the "Revolver" and, together with the Term Loan, the "Senior Secured Credit Facilities"). The Revolver will mature on August 31, 2022. As of December 31, 2020, our availability on the Revolver was \$112.5 million (including outstanding letters of credit of \$7.5 million).

On January 27, 2021, the Company entered into an amendment to the Senior Secured Credit Facilities, which amended and

supplemented the credit agreement to provide for an extension of the maturity date of the Revolver to February 1, 2026 and an increase in the outstanding commitments under the Revolver in an amount equal to \$50.0 million. The maturity extension and the additional commitments became operative on February 1, 2021. See Note 11. "Subsequent Events" to our consolidated financial statements included elsewhere in this Annual Report for a further discussion of the amendment.

The Revolver may be utilized for working capital, capital expenditures and general corporate purposes. Subject to certain conditions and requirements set forth in the credit agreement, we may request one or more additional incremental term loan facilities or one or more increases in the commitments on the Revolver.

The Senior Secured Credit Facilities bear interest at a rate per annum equal to (x) LIBOR plus a margin ranging from 3.00% to 3.25% per annum, depending on our first lien net leverage ratio or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate and (iii) one-month LIBOR plus 1.00% per annum (solely with respect to the Term Loan, the alternate base rate shall not be less than 2.00% per annum)) plus a margin ranging from 2.00% to 2.25% per annum. In addition, we are required to pay a commitment fee of 0.50% per annum in respect of unused commitments on the Revolver.

On April 22, 2020, we entered into a second incremental term loan amendment, which amended and supplemented the existing credit agreement, to provide for an incremental borrowing of \$120.0 million. The incremental amounts were fully drawn on April 22, 2020, and are included in the term loan borrowings discussed above. The incremental term loans bear interest at a rate per annum equal to (x) LIBOR plus a margin of 8.00% per annum or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate, (iii) one-month LIBOR plus 1.00% per annum and (iv) 2.00% per annum) plus a margin of 7.00% per annum.

On April 16, 2020, we entered into a third amendment to our credit agreement, which amended and supplemented financial covenants applicable to the Revolver under the credit agreement. Pursuant to the third amendment, the Company's requirement to comply with a maximum consolidated total net leverage ratio was waived for the remainder of 2020. Additionally, for the first three quarters of 2021, the third amendment provides for an alternative calculation for the maximum consolidated total net leverage ratio where the trailing four quarter basis may be negatively impacted by the impacts of the COVID-19 pandemic. The third amendment became effective concurrently with the funding of the incremental term loans on April 22, 2020, discussed above.

Senior Unsecured Notes

We have \$545.0 million aggregate principal amount of senior unsecured notes due April 15, 2027 (the "2027 Unsecured Notes"). The 2027 Unsecured Notes bear interest at the rate of 10.000% per year, payable semi-annually on April 15 and October 15 of each year. See Note 5. "Long-Term Debt" to our consolidated financial statements included elsewhere in this report for a further discussion of the senior unsecured notes.

On July 30, 2020, we completed the issuance and sale of \$115.0 million in aggregate principal amount of senior unsecured notes due 2027 at 100.75% of the principal amount. The notes were issued as part of the same series as the existing 2027 Unsecured Notes originally issued in April 2019, and have the same terms.

We have \$370.0 million aggregate principal amount of senior unsecured notes due July 1, 2025 outstanding (the "2025 Unsecured Notes"). The 2025 Unsecured Notes bear interest at the rate of 6.750% per year, payable semi-annually on January 1 and July 1 of each year.

Other Debt

We and certain of our subsidiaries have other debt consisting of outstanding bank indebtedness of \$137.5 million, which is collateralized by the real estate and equipment owned by the surgical facilities to which the loans were made, and right-of-use finance lease obligations of \$281.2 million for which we are liable to various vendors for several property and equipment leases classified as finance leases.

Capital Resources

In addition to cash flows from operations, available cash and capacity on our Revolver, other sources of capital include funds we have received under the CARES Act as well as continued access to the capital markets.

As noted in Note 1. "Organization and Summary of Accounting Policies" to our consolidated financial statements included elsewhere in this report, as of December 31, 2020, we received relief via the CARES Act, including approximately \$59 million in direct grant payments and approximately \$120 million of accelerated payments pursuant to the Medicare Accelerated and Advance Payment Program. The direct grant payments are not required to be repaid, subject to certain terms and conditions, while payments received under the Medicare Accelerated and Advance Payment Program are required to be repaid. As of December 31, 2020, approximately \$95 million of accelerated payments are reflected as a component of Medicare accelerated payments and deferred governmental grants in the consolidated balance sheets while the remaining payments are included within other long-term liabilities. Based on the repayment terms, we expect recoupment of these funds to begin in 2021 under the repayment framework more specifically described in Note 1. "Organization and Summary of Accounting Policies."

Additionally, the CARES Act permitted the deferral of payment of the social security payroll tax between March 27, 2020 and December 31, 2020, with half of the deferred amount due December 2021 and the other half due December 2022. As of December 31, 2020, we have deferred approximately \$16.9 million.

We believe that deferral of the social security payroll tax match, which we began doing in April 2020, along with the funds received under the CARES Act as noted above, have positively impacted our cash flows from operations during 2020.

Summary

The COVID-19 pandemic has resulted in, and may continue to result in, significant disruptions of financial and capital markets, which could reduce our ability to access capital and negatively affect our liquidity in the future. Additionally, while we have received grants and accelerated payments under the CARES Act and other government assistance programs and may receive additional amounts in the future, there is no assurance regarding the extent to which anticipated negative impacts arising from the COVID-19 pandemic will be offset by amounts and benefits received under the CARES Act or future legislation.

Although we have seen continued improvement in surgical case volumes as states begin to re-open and allow for non-emergent procedures, broad economic factors resulting from the current COVID-19 pandemic, including increased unemployment rates and reduced consumer spending, could negatively affect our payor mix, increase the relative proportion of lower margin services we provide and reduce patient volumes, as well as diminish our ability to collect outstanding receivables. Business closings and layoffs in the areas in which we operate may lead to increases in the uninsured and underinsured populations and adversely affect demand for our services, as well as the ability of payors to pay for services as rendered. Any increase in the amount or deterioration in the collectability of patient accounts receivable will adversely affect our cash flows and results of operations, requiring an increased level of working capital. If general economic conditions continue to deteriorate or remain uncertain for an extended period of time, our liquidity and ability to repay our outstanding debt may be harmed.

Based on our current level of operations, we believe cash flow from operations, available cash, available capacity on our Revolver, the incremental term loan borrowings and issuance of new notes discussed above, funds we have received under the CARES Act, funds we may receive in the future and continued access to capital markets, together with the cost cutting steps taken in response to the impact of the COVID-19 pandemic, as discussed in Item 1A. "Risk Factors" elsewhere in this report, will be adequate to meet our short-term (i.e., 12 months) and long-term (beyond 12 months) liquidity needs.

Certain Non-GAAP Measures

Adjusted EBITDA is not a measurement of financial performance under GAAP, and should not be considered in isolation or as a substitute for net income, operating income or any other measure calculated in accordance with GAAP. The items excluded from this non-GAAP metric are significant components in understanding and evaluating our financial performance. We believe such adjustments are appropriate, as the magnitude and frequency of such items can vary significantly and are not related to the assessment of normal operating performance. Our calculation of Adjusted EBITDA may not be comparable to similarly titled measures reported by other companies.

When we use the term "Adjusted EBITDA," we are referring to (loss) income before income taxes, adjusted for net income attributable to non-controlling interests, depreciation and amortization, net interest expense, equity-based compensation expense, transaction, integration and acquisition costs, impairment charges, net loss (gain) on disposals and deconsolidations, litigation settlements and other litigation costs, reserve adjustments, contingent acquisition compensation expense, gain on escrow release, loss on debt extinguishment and tax receivable agreement expense. When we use "Adjusted EBITDA excluding grant funds," we are referring to Adjusted EBITDA less the impact of grant funds. We use Adjusted EBITDA and Adjusted EBITDA excluding grant funds as measures of financial performance. Adjusted EBITDA and Adjusted EBITDA excluding grant funds are key measures used by our management to assess operating performance, make business decisions and allocate resources.

The following table reconciles Adjusted EBITDA and Adjusted EBITDA excluding grant funds to (loss) income before income taxes, the most directly comparable GAAP financial measure (in millions and unaudited):

	Year Ended December 31,		
	2020	2019	2018
Consolidated Statements of Operations Data:			
(Loss) income before income taxes	\$ (18.8)	\$ 54.6	\$ (69.2)
<i>Plus (minus):</i>			
Net income attributable to non-controlling interests	(117.4)	(119.9)	(110.1)
Depreciation and amortization	94.8	76.5	67.4
Interest expense, net	201.8	178.9	147.0
Equity-based compensation expense	13.2	10.2	9.3
Transaction, integration and acquisition costs ⁽¹⁾	38.2	36.1	34.0
Impairment charges	33.5	7.9	74.4
Loss (gain) on disposals and deconsolidations, net	5.7	(4.4)	31.8
Litigation settlement and other litigation costs ⁽²⁾	6.4	4.6	46.0
Reserve adjustments ⁽³⁾	—	—	2.7
Contingent acquisition compensation expense	—	—	1.5
Gain on escrow release ⁽⁴⁾	(0.8)	—	—
Loss on debt extinguishment	—	11.7	—
Tax receivable agreement expense	—	2.4	—
Adjusted EBITDA	<u>\$ 256.6</u>	<u>\$ 258.6</u>	<u>\$ 234.8</u>
Less: Impact of grant funds ⁽⁵⁾	(31.1)	—	—
Adjusted EBITDA excluding grant funds	<u>\$ 225.5</u>	<u>\$ 258.6</u>	<u>\$ 234.8</u>

- (1) For the year ended December 31, 2020, this amount includes transaction and integration costs of \$23.2 million, of which \$6.6 million were acquisition related costs, and includes start-up costs related to a de novo surgical hospital of \$15.0 million. For the year ended December 31, 2019, this amount includes transaction and integration costs of \$19.0 million, and further includes other acquisition costs and start-up costs related to a de novo surgical hospital of \$17.1 million. For the year ended December 31, 2018, this amount includes transaction and integration costs of \$31.7 million, and further includes other acquisition costs of \$2.3 million.
- (2) This amount includes litigation settlement costs of \$1.2 million, \$0.2 million and \$46.0 million for the years ended December 31, 2020, 2019 and 2018, respectively. This amount also includes other litigation costs of \$5.2 million and \$4.4 million for the years ended December 31, 2020 and 2019, respectively, with no comparable costs in 2018.
- (3) This amount represents adjustments to revenue in order to apply consistent policies to businesses acquired by Surgery Partners in prior periods.
- (4) Included in other income in the consolidated statement of operations for the year ended December 31, 2020, with no comparable gain in 2019 and 2018.
- (5) Represents the impact of grant funds recognized, net of amounts attributable to non-controlling interests.

We use Credit Agreement EBITDA as a measure of liquidity and to determine our compliance under certain covenants pursuant to our credit facilities. Credit Agreement EBITDA is determined on a trailing twelve-month basis. We have included it because we believe that it provides investors with additional information about our ability to incur and service debt and make capital expenditures. Credit Agreement EBITDA is not a measurement of liquidity under GAAP, and should not be considered in isolation or as a substitute for any other measure calculated in accordance with GAAP. The items excluded from Credit Agreement EBITDA are significant components in understanding and evaluating our liquidity. Our calculation of Credit Agreement EBITDA may not be comparable to similarly titled measures reported by other companies.

When we use the term "Credit Agreement EBITDA," we are referring to Adjusted EBITDA, as defined above, further adjusted for acquisitions and synergies. These adjustments do not relate to our historical financial performance and instead relate to estimates compiled by management and calculated in conformance with the definition of "Consolidated EBITDA" used in the credit agreements governing our credit facilities.

The following table reconciles Credit Agreement EBITDA to cash flows from operating activities, the most directly comparable GAAP financial measure (in millions and unaudited):

	Year Ended December 31, 2020
Cash flows from operating activities	\$ 246.9
<i>Plus (minus):</i>	
Non-cash interest income, net	(4.5)
Non-cash lease expense	(39.4)
Deferred income taxes	21.9
Income from equity investments, net of distributions received	(0.5)
Changes in operating assets and liabilities, net of acquisitions and divestitures	59.3
Medicare accelerated payments and deferred governmental grants	(135.2)
Income tax benefit	(20.1)
Net income attributable to non-controlling interests	(117.4)
Interest expense, net	201.8
Transaction, integration and acquisition costs	38.2
Litigation settlement and other litigation costs	6.4
Gain on escrow release	(0.8)
Acquisitions and synergies ⁽¹⁾	86.7
Credit Agreement EBITDA	<u>\$ 343.3</u>

(1) Represents impact of acquisitions as if each acquisition had occurred on January 1, 2020. Further this includes revenue synergies from other business initiatives, de novo facilities and an adjustment for the effects of adopting the new lease accounting standard, as defined in the credit agreement governing the Senior Secured Credit Facilities.

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations by period as of December 31, 2020 (in millions):

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Long-term debt obligations, including interest ⁽¹⁾	\$ 3,760.8	\$ 233.2	\$ 439.9	\$ 2,041.9	\$ 1,045.8
Operating lease obligations, including interest ⁽²⁾	526.4	70.7	128.2	108.4	219.1
Tax receivable agreement ⁽³⁾	43.2	21.2	21.5	0.5	—
Total contractual obligations	<u>\$ 4,330.4</u>	<u>\$ 325.1</u>	<u>\$ 589.6</u>	<u>\$ 2,150.8</u>	<u>\$ 1,264.9</u>

(1) Included in long-term debt obligations are principal and interest owed on our outstanding debt obligations. These amounts exclude our unamortized fair value adjustments related non-cash amortization for the Term Loan. These obligations are explained further in Note 5. "Long-Term Debt" to our consolidated financial statements included elsewhere in this Annual Report. We used the applicable annual interest rate as of December 31, 2020 of 4.25%, based on LIBOR plus the applicable margin, for our \$1.4 billion outstanding Term Loan to estimate interest payments on this variable rate debt instrument.

(2) This reflects our future operating lease payments. We enter into operating leases in the normal course of business. Substantially all of our operating lease agreements have fixed payment terms based on the passage of time. Some lease agreements provide us with the option to renew the lease. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. These obligations are explained further in Note 6. "Leases" to our consolidated financial statements included elsewhere in this Annual Report. Operating lease obligations do not include common area maintenance, insurance or tax payments for which we are also obligated to pay.

(3) This reflects payments made pursuant to the terms of the TRA, as described further in "Critical Accounting Policies and Tax Receivable Agreement."

Inflation

Inflation and changing prices have not significantly affected our operating results or the markets in which we operate.

Recent Accounting Pronouncements

Please refer to Note 1. "Organization and Summary of Accounting Policies - Recent Accounting Pronouncements" to our consolidated financial statements included elsewhere in this Annual Report for a discussion of the impact of the adoption of recently issued accounting standards and accounting standards not yet adopted.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are subject to market risk primarily from exposure to changes in interest rates based on our financing, investing and cash management activities. We utilize a balanced mix of maturities along with both fixed rate and variable rate debt to manage our exposures to changes in interest rates. Additionally, we periodically enter into interest rate swap agreements to manage our exposure to interest rate fluctuations. Our interest rate swap agreements involve the exchange of fixed and variable rate interest payments between two parties, based on common notional principal amounts and maturity dates. The notional amounts of the swap agreements represent balances used to calculate the exchange of cash flows and are not our assets or liabilities. Our credit risk related to these agreements is considered low because the swap agreements are with creditworthy financial institutions. The interest payments under these agreements are settled on a net basis. These derivatives have been recognized in the financial statements at their respective fair values. Changes in the fair value of these derivatives, which are designated as cash flow hedges, are included in other comprehensive income.

Our variable rate debt instruments are primarily indexed to the prime rate or LIBOR. Interest rate changes would result in gains or losses in the market value of our fixed rate debt portfolio due to differences in market interest rates and the rates at the inception of the debt agreements. Based on our indebtedness and the effect of our interest rate swap agreements at December 31, 2020, a 100 basis point interest rate change would impact our net earnings and cash flow by approximately \$3.5 million annually. Although there can be no assurances that interest rates will not change significantly, we do not expect changes in interest rates to have a material effect on our net earnings or cash flows in 2021 based on our indebtedness at December 31, 2020.

Item 8. Financial Statements and Supplementary Data

Information with respect to this Item is contained in our consolidated financial statements beginning on Page [F-1](#) of this Annual Report.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures and Limitations on the Effectiveness of Controls

An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Annual Report to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report. Based on the evaluation of our disclosure controls and procedures conducted as of December 31, 2020, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate "internal control over financial reporting" (as such term is defined in Rule 13a-15(f) under the Exchange Act) for the Company. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions and disposition of assets; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures are made only in accordance with management and board authorizations; and providing reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements prepared for external purposes in accordance with GAAP. Because of the inherent limitations in any internal control, no matter how well designed, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2020. The assessment was based on criteria established in the framework *Internal Control-Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management, including the Chief Executive Officer and Chief Financial Officer, determined that our internal control over financial reporting was effective as of December 31, 2020.

Deloitte & Touche LLP, the Company's independent registered public accounting firm, has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2020. Their attestation report is included below in this Item 9A.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended December 31, 2020 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Surgery Partners, Inc.

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Surgery Partners, Inc. and subsidiaries (the “Company”) as of December 31, 2020, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2020, of the Company and our report dated March 10, 2021, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management’s Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Deloitte & Touche LLP

Nashville, Tennessee
March 10, 2021

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information called for by Item 10 is incorporated herein by reference to the definitive Proxy Statement of the Company relating to the 2021 Annual Meeting of Stockholders (the "Definitive Proxy Statement"), which the Company intends to file within 120 days after the close of its fiscal year ended December 31, 2020.

Item 11. Executive Compensation

The information called for by Item 11 is incorporated herein by reference to the Definitive Proxy Statement referenced above in Item 10.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information called for by Item 12 is incorporated herein by reference to the Definitive Proxy Statement referenced above in Item 10.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information called for by Item 13 is incorporated herein by reference to the Definitive Proxy Statement referenced above in Item 10.

Item 14. Principal Accounting Fees and Services

The information called for by Item 14 is incorporated herein by reference to the Definitive Proxy Statement referenced above in Item 10.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Financial Statements, Financial Statement Schedules and Exhibits

(1) Financial Statements

Our Consolidated Financial Statements and Notes thereto are set forth starting on page [F-1](#) of this Annual Report on Form 10-K.

(2) Financial Statement Schedules

All financial schedules have been omitted either because they are not applicable or because the required information is provided in our Consolidated Financial Statements and Notes thereto, starting on page [F-1](#) of this Annual Report on Form 10-K.

(3) Exhibits:

No.	Description
2.1	Agreement and Plan of Merger by and among Surgery Partners, Inc., SP Merger Sub, Inc., NSH Holdco, Inc. and IPC / NSH, L.P., dated as of May 9, 2017 (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed May 11, 2017).*
2.2	Letter Amendment to Merger Agreement, by and among Surgery Partners, Inc., SP Merger Sub, Inc., NSH Holdco, Inc. and IPC / NSH, L.P., dated as of July 7, 2017 (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed July 11, 2017).*
3.1	Amended and Restated Certificate of Incorporation of Surgery Partners, Inc., dated October 30, 2017 (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed November 3, 2017).
3.2	Certificate of Designations, Preferences, Rights and Limitations of the 10.00% Series A Convertible Perpetual Participating Preferred Stock of Surgery Partners, Inc., dated August 31, 2017 (incorporated herein by reference to Exhibit 3.3 to the Company's Current Report on Form 8-K filed September 1, 2017).
3.3	Amended and Restated Bylaws of Surgery Partners, Inc., dated August 31, 2017 (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed September 1, 2017).
4.1	Description of Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934 (incorporated herein by reference to Exhibit 4.1 to the Company's Annual Report on Form 10-K filed March 5, 2020).
4.2	Indenture, dated June 30, 2017, among SP Finco, LLC and Wilmington Trust, National Association, as Trustee (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed July 6, 2017).
4.3	First Supplemental Indenture, by and among Surgery Center Holdings, Inc., Wilmington Trust, National Association, as Trustee, and certain other parties thereto, dated August 31, 2017 (incorporated herein by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed September 1, 2017).
4.4	Indenture by and among Surgery Center Holdings, Inc., the guarantors from time to time party thereto and Wilmington Trust, National Association, dated April 11, 2019 (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed April 12, 2019).
4.5	Second Supplemental Indenture, dated July 30, 2020, among Surgery Center Holdings, Inc., the guarantors party thereto and Wilmington Trust, National Association, as Trustee (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed July 31, 2020).
10.1	First Lien Incremental Term Loan Amendment and Consent, dated as of March 24, 2016, by and among SP Holdco I, Inc., Surgery Center (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 30, 2016).
10.2	Amendment No. 4 to Credit Agreement, dated as of September 26, 2016, by and among SP Holdco I, Inc., Surgery Center Holdings, Inc., Jefferies Finance LLC and the other guarantors and lenders party thereto (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 27, 2016).
10.3	Office Lease Agreement dated November 17, 2015 between Highwoods Realty Limited Partnership and Surgery Partners, Inc. (incorporated herein by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K filed March 11, 2016).
10.4	First Amendment to Lease Agreement, dated August 29, 2016, between Highwood Realty Limited Partnership and Surgery Partners, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed November 10, 2016).
10.5	Second Amendment to Lease Agreement, dated April 26, 2017, between Highwoods Realty Limited Partnership and Surgery Partners, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed May 10, 2017).
10.6	Amended and Restated Registration Rights Agreement by and among Surgery Partners, Inc., certain stockholders of Surgery Partners, Inc. and certain other parties thereto, dated August 31, 2017 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 1, 2017).
10.7	Credit Agreement, by and among SP Holdco I, Inc., Surgery Center Holdings, Inc., Jefferies Finance LLC and the other guarantors and lenders party thereto, dated August 31, 2017 (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed September 1, 2017).*
10.8	Incremental Term Loan Amendment, dated as of October 23, 2018 with Jefferies, SP Holdco I, Inc., Surgery Center Holdings, Inc. and certain other parties thereto (incorporated herein by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K filed March 15, 2019).
10.9	Second Incremental Term Loan Amendment, dated as of April 22, 2020, by and among SP Holdco I, Inc., Surgery Center Holdings, Inc., Jefferies Finance LLC and the other guarantors and lenders party thereto (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed April 22, 2020).

- 10.10 [Amendment to the Credit Agreement, by and among SP Holdco I, Inc., Surgery Center Holdings, Inc., Jefferies Finance LLC and the other guarantors and lenders party thereto, dated March 25, 2019 \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 25, 2019\).](#)
- 10.11 [Third Amendment to the Credit Agreement, dated as of April 16, 2020, by and among SP Holdco I, Inc., Surgery Center Holdings, Inc., Jefferies Finance LLC and the other lenders party thereto \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 22, 2020\).](#)
- 10.12 [Fifth amendment to credit agreement, dated as of January 27, 2021, by and among SP Holdco I, Inc., Surgery Center Holdings, Inc., Jefferies Finance LLC and the other guarantors and lenders party thereto.](#)
- 10.13 [Tax Receivable Agreement, dated as of September 30, 2015, among Surgery Partners, Inc., H.I.G. Surgery Centers, LLC and certain other stockholders party thereto \(incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed November 13, 2015\).](#)
- 10.14 [Amendment No. 1 to Income Tax Receivable Agreement, by and between Surgery Partners, Inc. and H.I.G. Surgery Centers, LLC \(in its capacity as the Stockholders Representative\), dated May 9, 2017 \(incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed May 11, 2017\).](#)
- 10.15 [Form of TRA Waiver and Assignment Agreement \(incorporated herein by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K filed March 16, 2018\).](#)
- 10.16 (a) [Form of Indemnification Agreement \(incorporated herein by reference to Exhibit 10.14 to Amendment No. 1 to the Company's Registration Statement on Form S-1, filed September 14, 2015\).](#)
- 10.17 (a) [Surgery Partners, Inc. 2015 Omnibus Incentive Plan, as amended and restated effective January 1, 2020 \(incorporated herein by reference as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed August 5, 2020\).](#)
- 10.18 (a) [Surgery Partners, Inc. Cash Incentive Plan, as amended and restated effective January 1, 2020 \(incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed August 5, 2020\).](#)
- 10.19 (a) [Symbion, Inc. Supplemental Executive Retirement Plan, Effective May 1, 2005 \(incorporated herein by reference to Exhibit 10.17 to the Company's Registration Statement on Form S-1, Amended, filed September 21, 2015\).](#)
- 10.20 (a) [Form of Non-Statutory Stock Option Agreement under the 2015 Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q filed November 13, 2015\).](#)
- 10.21 (a) [Form of Non-Employee Director Non-Statutory Stock Option Agreement under the Surgery Partners, Inc. 2015 Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q filed November 13, 2015\).](#)
- 10.22 (a) [Form of Restricted Stock Agreement under the Surgery Partners, Inc. 2015 Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q filed November 13, 2015\).](#)
- 10.23 (a) [Form of Restricted Stock Award Agreement under the 2015 Surgery Partners, Inc. Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed March 15, 2016\).](#)
- 10.24 (a) [Form of Performance Stock Unit Award Agreement under the Surgery Partners, Inc. 2015 Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 5, 2016\).](#)
- 10.25 (a) [Form of Non-Employee Director Restricted Stock Award Agreement under the Surgery Partners, Inc. 2015 Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 3, 2017\).](#)
- 10.26 (a) [Form of Stock-Settled Stock Appreciation Right Agreement under the Surgery Partners, Inc. 2015 Omnibus Incentive Plan \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed December 20, 2018\).](#)
- 10.27 (a) [Amended and Restated Employment Agreement, dated April 13, 2017, by and between Surgery Partners, Inc., Symbion, Inc. and Jennifer Baldock \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 17, 2017\).](#)
- 10.28 (a) [Employment Agreement, dated September 7, 2017, between Surgery Partners, Inc. and Cliff Adlerz \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 8, 2017\).](#)
- 10.29 (a) [Employment Agreement, dated January 4, 2018, between Surgery Partners, Inc., Surgery Partners, LLC and Wayne DeVeydt \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed January 8, 2018\).](#)
- 10.30 (a) [Amendment No. 1 to Employment Agreement by and between Surgery Partners, Inc., Surgery Partners, LLC and Wayne DeVeydt, dated January 13, 2020 \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 13, 2020\).](#)
- 10.31 (a) [Employment Agreement, dated March 9, 2018, by and between Surgery Partners, Inc. and Thomas F. Cowhey \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 12, 2018\).](#)
- 10.32 (a) [Employment Agreement, dated February 11, 2019, by and between Surgery Partners, Inc., Surgery Partners, LLC and J. Eric Evans \(incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 12, 2019\).](#)
- 10.33 (a) [Amendment No. 1 to Employment Agreement by and between Surgery Partners, Inc., Surgery Partners, LLC and J. Eric Evans, dated January 13, 2020 \(incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on January 13, 2020\).](#)
- 10.34 (a) [Employment Agreement by and between Symbion, Inc. and George M. Goodwin, dated June 13, 2014 \(incorporated herein by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on May 10, 2019\).](#)
- 10.35 (a) [Employment Agreement, dated June 13, 2014, by and between Symbion, Inc. and Anthony W. Taparo, as amended by that certain First Amendment to Employment Agreement dated July 31, 2016, and that certain Second Amendment to Employment Agreement dated August 7, 2019.](#)
- 10.36 (a) [Employment Agreement, dated November 12, 2019, by and between Surgery Partners, Inc. and Bradley R. Owens.](#)
- 10.37 (a) [Employment Agreement, dated June 30, 2019, by and between Surgery Partners, Inc. and Laura L. Brocklehurst.](#)
- 10.38 [Settlement Agreement regarding Logan Laboratories, LLC and Tampa Pain Relieve Centers, Inc., dated April 14, 2020 \(incorporated herein by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed May 11, 2020\).](#)

21.1	List of Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm (Deloitte).
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Taxonomy Extension Instance Document - the instance document does not appear in the interactive data file because its XBRL tags are embedded within the inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	The cover page from the Company's Annual Report on Form 10-K for the year ended December 31, 2020, formatted in Inline XBRL (included in Exhibit 101).

(a) Management Contract or Compensatory Plan or Arrangement.

* Schedules and/or Exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish a supplemental copy of any omitted schedule or exhibit to the SEC upon request.

Item 16. Form 10-K Summary

None.

INDEX TO FINANCIAL STATEMENTS

	Page
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets - December 31, 2020 and 2019	F-4
Consolidated Statements of Operations - for the years ended December 31, 2020, 2019 and 2018	F-5
Consolidated Statements of Comprehensive Income (Loss) - for the years ended December 31, 2020, 2019 and 2018	F-6
Consolidated Statements of Stockholders' Equity - for the years ended December 31, 2020, 2019 and 2018	F-7
Consolidated Statements of Cash Flows - for the years ended December 31, 2020, 2019 and 2018	F-8
Notes to Consolidated Financial Statements	F-9

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Surgery Partners, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Surgery Partners, Inc. and subsidiaries (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows, for each of the three years in the period ended December 31, 2020, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2021, expressed an unqualified opinion on the Company's internal control over financial reporting.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company has adopted Accounting Standards Codification Topic 842, "Leases", using the modified retrospective adoption method on January 1, 2019.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current-period audit of the financial statements that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Accounts Receivable — Refer to Note 1 to the financial statements

Critical Audit Matter Description

Accounts receivable are recorded net of estimated implicit price concessions at both surgical hospitals and ambulatory surgical centers. At surgical hospitals, the estimation process is based on historical trend of cash collections and contractual write-offs. The inputs used to determine the estimated implicit price concessions are based on objective data. Management's determination of the estimate is complex and involves their assessment of the appropriateness and relevancy of the inputs and methodology to record accounts receivable at the net realizable value.

We identified surgical hospitals accounts receivable as a critical audit matter because of the significant estimates management makes to determine the implicit price concession. This required a high degree of auditor judgment and an increased extent of effort when performing audit procedures to evaluate the methodology and application of the Company's estimated implicit price concessions for the surgical hospitals.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to the Company's estimated implicit price concessions for surgical hospitals include the following, among others:

- We tested the effectiveness of controls over accounts receivable, including management's controls over the review of the implicit price concessions and the verification of the accuracy and completeness of the data used in the assessment.

- We evaluated management’s methodology and related assumptions, including cash collections, used in recording implicit price concessions, by comparing actual results to management’s historical estimates.
- We tested the underlying data related to the recognition of patient level charges and the subsequent activities, including cash collections and contractual write-offs.
- We tested the mathematical accuracy of the estimates applied to period-end accounts receivable.
- We considered industry, economic, and company factors to determine the appropriateness of the net realizable value of accounts receivable.

/s/ Deloitte & Touche LLP

Nashville, Tennessee
March 10, 2021

We have served as the Company's auditor since 2018.

SURGERY PARTNERS, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in millions, except per share amounts)

	December 31,	
	2020	2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 317.9	\$ 92.7
Accounts receivable	382.2	326.9
Inventories	56.4	46.3
Prepaid expenses	17.6	17.8
Other current assets	27.4	41.8
Total current assets	801.5	525.5
Property and equipment, net	544.6	523.3
Intangible assets, net	46.9	47.3
Goodwill	3,468.0	3,402.4
Investments in and advances to affiliates	90.3	93.2
Right-of-use operating lease assets	310.1	297.7
Long-term deferred tax assets	124.8	98.7
Other long-term assets	27.0	30.8
Total assets	<u>\$ 5,413.2</u>	<u>\$ 5,018.9</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 100.2	\$ 96.7
Accrued payroll and benefits	65.4	54.2
Medicare accelerated payments and deferred governmental grants	109.8	—
Other current liabilities	217.0	191.2
Current maturities of long-term debt	64.4	56.0
Total current liabilities	556.8	398.1
Long-term debt, less current maturities	2,792.4	2,524.7
Right-of-use operating lease liabilities	300.9	283.1
Other long-term liabilities	139.7	113.6
Non-controlling interests—redeemable	306.8	321.0
Redeemable preferred stock - Series A; shares authorized, issued and outstanding - 310,000; redemption value - \$434.5 and \$395.0, respectively	434.5	395.0
Stockholders' equity:		
Preferred stock, \$0.01 par value; shares authorized - 20,000,000; shares issued or outstanding - none	—	—
Common stock, \$0.01 par value; shares authorized - 300,000,000; shares issued and outstanding - 50,461,706 and 49,298,940, respectively	0.5	0.5
Additional paid-in capital	607.9	662.7
Accumulated other comprehensive loss	(61.0)	(50.7)
Retained deficit	(431.8)	(315.7)
Total Surgery Partners, Inc. stockholders' equity	115.6	296.8
Non-controlling interests—non-redeemable	766.5	686.6
Total stockholders' equity	882.1	983.4
Total liabilities and stockholders' equity	<u>\$ 5,413.2</u>	<u>\$ 5,018.9</u>

See notes to consolidated financial statements.

SURGERY PARTNERS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in millions, except per share amounts; shares in thousands)

	Year Ended December 31,		
	2020	2019	2018
Revenues	\$ 1,860.1	\$ 1,831.4	\$ 1,771.5
Operating expenses:			
Salaries and benefits	550.3	550.0	534.7
Supplies	538.4	507.9	490.3
Professional and medical fees	191.4	154.8	145.5
Lease expense	87.4	85.6	86.7
Other operating expenses	112.8	109.3	104.2
Cost of revenues	1,480.3	1,407.6	1,361.4
General and administrative expenses	97.1	88.6	93.6
Depreciation and amortization	94.8	76.5	67.4
Income from equity investments	(10.8)	(10.2)	(8.9)
Loss (gain) on disposals and deconsolidations, net	5.7	(4.4)	31.8
Transaction and integration costs	23.2	19.0	31.7
Impairment charges	33.5	7.9	74.4
Grant funds	(46.2)	—	—
Loss on debt extinguishment	—	11.7	—
Litigation settlement	1.2	0.2	46.0
Other income	(1.7)	(1.4)	(3.7)
Total operating expenses	1,677.1	1,595.5	1,693.7
Operating income	183.0	235.9	77.8
Tax receivable agreement expense	—	(2.4)	—
Interest expense, net	(201.8)	(178.9)	(147.0)
(Loss) income before income taxes	(18.8)	54.6	(69.2)
Income tax (benefit) expense	(20.1)	9.5	26.4
Net income (loss)	1.3	45.1	(95.6)
Less: Net income attributable to non-controlling interests	(117.4)	(119.9)	(110.1)
Net loss attributable to Surgery Partners, Inc.	(116.1)	(74.8)	(205.7)
Less: Amounts attributable to participating securities	(39.5)	(35.7)	(32.4)
Net loss attributable to common stockholders	\$ (155.6)	\$ (110.5)	\$ (238.1)
Net loss per share attributable to common stockholders - basic and diluted ⁽¹⁾	\$ (3.19)	\$ (2.29)	\$ (4.96)
Weighted average common shares outstanding - basic and diluted ⁽¹⁾	48,776	48,280	48,028

(1) The impact of potentially dilutive securities for all periods were not considered because the effect would be anti-dilutive in those periods.

See notes to consolidated financial statements.

SURGERY PARTNERS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Dollars in millions)

	<u>Year Ended December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Net income (loss)	\$ 1.3	\$ 45.1	\$ (95.6)
Other comprehensive (loss) income, net of tax:			
Derivative activity	(10.3)	(28.3)	(22.4)
Comprehensive (loss) income	(9.0)	16.8	(118.0)
Less: Comprehensive income attributable to non-controlling interests	(117.4)	(119.9)	(110.1)
Comprehensive loss attributable to Surgery Partners, Inc.	<u>\$ (126.4)</u>	<u>\$ (103.1)</u>	<u>\$ (228.1)</u>

See notes to consolidated financial statements.

SURGERY PARTNERS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Dollars in millions; shares in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Deficit	Non-Controlling Interests— Non-Redeemable	Total
	Shares	Amount					
Balance as of December 31, 2017	48,687	\$ 0.5	\$ 695.5	\$ —	\$ (41.3)	\$ 681.9	\$ 1,336.6
Net (loss) income	—	—	—	—	(205.7)	75.5	(130.2)
Equity-based compensation	339	—	8.1	—	—	—	8.1
Preferred dividends	—	—	(32.4)	—	—	—	(32.4)
Other comprehensive loss	—	—	—	(22.4)	—	—	(22.4)
Repurchase of shares	(157)	—	(2.0)	—	—	—	(2.0)
Acquisition and disposal of shares of non-controlling interests, net	—	—	4.3	—	—	15.8	20.1
Distributions to non-controlling interests—non-redeemable holders	—	—	—	—	—	(78.3)	(78.3)
Other	—	—	—	—	—	(0.6)	(0.6)
Balance as of December 31, 2018	48,869	0.5	673.5	(22.4)	(247.0)	694.3	1,098.9
Net (loss) income	—	—	—	—	(74.8)	80.8	6.0
Equity-based compensation	430	—	9.2	—	—	—	9.2
Preferred dividends	—	—	(35.7)	—	—	—	(35.7)
Other comprehensive loss	—	—	—	(28.3)	—	—	(28.3)
Acquisition and disposal of shares of non-controlling interests, net	—	—	15.7	—	—	(7.4)	8.3
Distributions to non-controlling interests—non-redeemable holders	—	—	—	—	—	(81.2)	(81.2)
Impact of adoption of ASC 842	—	—	—	—	6.1	—	6.1
Other	—	—	—	—	—	0.1	0.1
Balance as of December 31, 2019	49,299	0.5	662.7	(50.7)	(315.7)	686.6	983.4
Net (loss) income	—	—	—	—	(116.1)	85.7	(30.4)
Equity-based compensation	1,163	—	12.4	—	—	—	12.4
Preferred dividends	—	—	(39.5)	—	—	—	(39.5)
Other comprehensive loss	—	—	—	(10.3)	—	—	(10.3)
Acquisition and disposal of shares of non-controlling interests, net	—	—	(27.7)	—	—	67.5	39.8
Distributions to non-controlling interests—non-redeemable holders	—	—	—	—	—	(73.1)	(73.1)
Other	—	—	—	—	—	(0.2)	(0.2)
Balance as of December 31, 2020	50,462	\$ 0.5	\$ 607.9	\$ (61.0)	\$ (431.8)	\$ 766.5	\$ 882.1

See notes to consolidated financial statements.

SURGERY PARTNERS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in millions)

	Year Ended December 31,		
	2020	2019	2018
Cash flows from operating activities:			
Net income (loss)	\$ 1.3	\$ 45.1	\$ (95.6)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	94.8	76.5	67.4
Non-cash interest expense (income), net	4.5	2.5	(1.4)
Equity-based compensation expense	13.2	10.2	9.3
Loss (gain) on disposals and deconsolidations, net	5.7	(4.4)	31.8
Impairment charges	33.5	7.9	74.4
Loss on debt extinguishment	—	11.7	—
Deferred income taxes	(21.9)	8.5	25.3
Income from equity investments, net of distributions received	0.5	0.3	0.2
Non-cash lease expense	39.4	40.0	—
Changes in operating assets and liabilities, net of acquisitions and divestitures:			
Accounts receivable	(46.6)	(23.5)	(22.8)
Medicare accelerated payments and deferred governmental grants	135.2	—	—
Other operating assets and liabilities	(12.7)	(45.3)	56.0
Net cash provided by operating activities	<u>246.9</u>	<u>129.5</u>	<u>144.6</u>
Cash flows from investing activities:			
Purchases of property and equipment	(42.9)	(73.6)	(39.8)
Payments for acquisitions, net of cash acquired	(104.6)	(13.8)	(106.8)
Proceeds from disposals of facilities and other assets	58.5	17.6	19.2
Purchase of equity investments	—	(15.2)	—
Other investing activities	0.6	(0.2)	(1.5)
Net cash used in investing activities	<u>(88.4)</u>	<u>(85.2)</u>	<u>(128.9)</u>
Cash flows from financing activities:			
Principal payments on long-term debt	(216.3)	(490.8)	(157.6)
Borrowings of long-term debt	429.4	506.9	282.7
Payments of debt issuance costs	(8.5)	(8.9)	(3.0)
Payment of premium on debt extinguishment	—	(17.8)	—
Distributions to non-controlling interest holders	(109.6)	(121.2)	(109.0)
Payments related to ownership transactions with non-controlling interest holders	(27.4)	(3.2)	(2.2)
Payments of preferred dividends	—	—	(7.8)
Repurchase of shares	—	—	(2.0)
Other financing activities	(0.9)	(0.9)	(7.4)
Net cash provided by (used in) financing activities	<u>66.7</u>	<u>(135.9)</u>	<u>(6.3)</u>
Net increase (decrease) in cash, cash equivalents and restricted cash	225.2	(91.6)	9.4
Cash, cash equivalents and restricted cash at beginning of period	93.0	184.6	175.2
Cash, cash equivalents and restricted cash at end of period	<u>\$ 318.2</u>	<u>\$ 93.0</u>	<u>\$ 184.6</u>
Supplemental cash flow information:			
Interest paid, net of interest income received	203.6	180.3	145.4
Cash paid for income taxes	1.7	1.6	2.2
Non-cash purchases of property and equipment	27.7	30.7	61.0

See notes to consolidated financial statements.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Accounting Policies

Organization

Surgery Partners, Inc., a Delaware corporation (together with its subsidiaries, the "Company"), was formed April 2, 2015. On August 31, 2017, a fund advised by an affiliate of Bain Capital Private Equity LP ("Bain Capital") became the controlling stockholder of the Company, holding Series A Preferred Stock (as defined in Note 7. "Redeemable Preferred Stock") and common stock that collectively represented approximately 65.7% of the voting power of all classes of capital stock of the Company as of August 31, 2017. As of December 31, 2020, Bain Capital held approximately 67.0% of the voting power of all classes of capital stock of the Company.

As of December 31, 2020, the Company owned and operated a national network of surgical facilities and ancillary services in 30 states. The surgical facilities, which include ambulatory surgery centers ("ASCs") and surgical hospitals, primarily provide non-emergency surgical procedures across many specialties, including, among others, gastroenterology, general surgery, ophthalmology, orthopedics and pain management. The Company's surgical hospitals also provide services such as diagnostic imaging, laboratory, obstetrics, oncology, pharmacy, physical therapy and wound care. Ancillary services are comprised of multi-specialty physician practices, urgent care facilities and anesthesia services.

As of December 31, 2020, the Company owned or operated a portfolio of 127 surgical facilities, comprised of 110 ASCs and 17 surgical hospitals. The Company owns these facilities in partnership with physicians and, in some cases, health care systems in the markets and communities it serves. The Company owned a majority interest in 84 of the surgical facilities and consolidated 107 of the facilities for financial reporting purposes.

Basis of Presentation

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and footnotes. Examples include, but are not limited to, estimates of accounts receivable allowances, professional and general liabilities and the estimate of deferred tax assets or liabilities. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, as well as interests in partnerships and limited liability companies controlled by the Company through its ownership of a majority voting interest or other rights granted to the Company by contract to manage and control the affiliate's business. All significant intercompany balances and transactions are eliminated in consolidation.

COVID-19 Pandemic

The COVID-19 global pandemic has significantly affected the Company's facilities, employees, patients, communities, business operations and financial performance, as well as the U.S. economy and financial markets. Beginning mid-March, the COVID-19 pandemic began to negatively affect the Company's net revenue and business operations. Due in part to local, state and federal guidelines, as well as recommendations from major medical societies, requiring social distancing and self-quarantines in response to the COVID-19 pandemic, surgical case volumes across most of the Company's surgical facilities were significantly impacted in the second quarter of 2020. The impact of COVID-19 on the Company's surgical facilities varies based on the market in which the facility operates, the type of surgical facility and the procedures that are typically performed. Although the Company cannot provide any certainty regarding the length and severity of the impact of the COVID-19 pandemic, surgical case volumes improved in the second half of 2020 as states began to re-open and allow for non-emergent procedures. The Company's operating structure naturally enables some flexibility in the cost structure according to the volume of surgical procedures performed, including much of its cost of revenues. In addition to the natural variability of these costs, the Company and its partners in the surgical facilities have undertaken additional steps to preserve financial flexibility. Beginning in mid-March, and for the remainder of 2020, the Company took actions that included significantly reducing cash operating expenses and deferring non-essential expenditures at the height of the crisis.

CARES Act

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law to provide stimulus funding for the U.S. economy. As part of the CARES Act, the U.S. government initially announced that it would offer \$100 billion of relief to eligible health care providers. On April 7, 2020, Centers for Medicare and Medicaid Services ("CMS") officials indicated they would distribute \$30 billion of direct grants to hospitals, ASCs and other health care providers based on how much they bill Medicare. Payments received from these grants are not required to be repaid provided the recipients attest to and comply with certain terms and conditions, including limitations on balance billing and not using funds received from the grants to reimburse expenses or losses that other sources are obligated to reimburse. The Company received approximately \$59 million of the grant funds distributed under the CARES Act and other governmental assistance programs during the year ended December 31, 2020. The recognition of amounts received is conditioned upon attestation with terms and conditions that funds will be used for COVID-19 related healthcare expenses or lost revenues.

The Company's assessment of whether the terms and conditions for amounts received are reasonably assured of having been met considers, among other things, the CARES Act, the COVID-19 Economic Relief Bill, enacted on December 27, 2020, and all frequently

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

asked questions and other interpretive guidance issued by HHS, including the Post-Payment Notice of Reporting Requirements issued on January 15, 2021 (the "January 15, 2021 Notice") and frequently asked questions issued by HHS on January 28, 2021 which clarified previously issued guidance, as well as expenses incurred attributable to COVID-19 and the Company's results of operations during such period as compared to the Company's budget. Such guidance, set forth the allowable methods for quantifying eligible healthcare related expenses and lost revenues. Only healthcare related expenses attributable to COVID-19 that another source has not reimbursed and is not obligated to reimburse are eligible to be claimed. As a result, the Company estimates approximately \$46.2 million of grant funds received qualified for recognition as a reduction in operating expenses under the caption Grant funds in the consolidated statements of operations for the year ended December 31, 2020. While the January 15, 2021 Notice and frequently asked questions issued by HHS on January 28, 2021 indicate that targeted distribution payments may be allocated or transferred to subsidiaries, distinct conditions exist for such allocations or transfers. There are significant uncertainties as to the meaning and interpretation of conditions specific to the allocation or transfer of targeted distribution payments such that, as of December 31, 2020, the Company is not reasonably assured that it can or will choose to comply with such conditions in order to allocate or transfer targeted distribution payments.

Amounts received, but not recognized as a reduction to operating expenses as of December 31, 2020, are reflected as a component of Medicare accelerated payments and deferred governmental grants in the consolidated balance sheets as of December 31, 2020, and such unrecognized amounts may be recognized as a reduction in operating expenses in future periods if the underlying conditions for recognition are met. HHS' interpretation of the underlying terms and conditions of grant funds received through the CARES Act and other governmental assistance programs, including auditing and reporting requirements, may evolve. Additional guidance or new and amended interpretations of existing guidance on the terms and conditions of such payments may result in the Company's inability to recognize certain payments, changes in the estimate of amounts recognized, or the derecognition of amounts previously recognized, which may be material.

As a way to increase cash flow to Medicare providers impacted by the COVID-19 pandemic, the CARES Act expanded the Medicare Accelerated and Advance Payment Program, which allows for most providers and suppliers, including the Company's surgical hospitals and ASCs to request an advance payment of anticipated Medicare revenues. ASCs could request up to 100% of the Medicare Fee-for-Service payment amount for a three-month period. Hospitals could request up to 100% of the payment amount for a six-month period, with certain critical access hospitals able to request up to 125% of the payment for a six-month period. Under the current terms of the program, all providers will have 29 months from the date of their first program payment to repay the full amount of the accelerated or advance payments they have received. The revised terms extend the period before repayment begins from 210 days to one year from the date that payment under the program was received. Once the repayment period begins, the offset will be limited to 25% of new claims during the first 11 months of repayment and 50% of new claims during the final 6 months. The revised program terms also lower the interest rate on outstanding amounts due at the end of the repayment period from 10% to 4%. The Company received approximately \$120 million of accelerated payments during the year ended December 31, 2020. These accelerated payments received were deferred. The current portion was approximately \$95 million and is included as a component of Medicare accelerated payments and deferred governmental grants in the consolidated balance sheets as of December 31, 2020. The long-term portion is included as a component of other long-term liabilities in the consolidated balance sheets. The Company does not expect to receive additional Medicare accelerated payments.

The CARES Act also provides for the deferral of the Company's portion of social security payroll taxes for the remainder of 2020. Under the CARES Act, half of the deferred amount will have to be paid in each of December 2021 and December 2022. The Company began deferring the social security payroll tax match in April 2020. As of December 31, 2020, the Company has deferred approximately \$16.9 million. The current portion is included as a component of accrued payroll and benefits and the long term portion is included as a component of other long-term liabilities in the consolidated balance sheets as of December 31, 2020.

The Company is continuing to closely monitor legislative actions and regulatory guidance at the federal, state and local levels with respect to the CARES Act as other governmental assistance might become available to the Company.

Variable Interest Entities

The consolidated financial statements include the accounts of variable interest entities ("VIE") in which the Company is the primary beneficiary under the provisions of Accounting Standards Codification 810, *Consolidation*. The Company has the power to direct the activities that most significantly impact a variable interest entity's economic performance. Additionally, the Company would absorb the majority of the expected losses from any of these entities should such expected losses occur. At December 31, 2020, the variable interest entities include four surgical facilities and three physician practices.

The total assets (excluding goodwill and intangible assets, net) of the consolidated VIEs included in the accompanying consolidated balance sheets as of December 31, 2020 and 2019, were \$27.7 million and \$36.2 million, respectively, and the total liabilities of the consolidated VIEs were \$21.1 million and \$25.2 million, respectively.

Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in an orderly transaction between market participants to sell the asset or transfer the liability. The Company uses fair value measurements based on inputs classified into the following hierarchy:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These may include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, depending on the nature of the item being valued.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, restricted invested assets and accounts payable approximate their fair values under Level 3 calculations.

A summary of the carrying amounts and fair values of the Company's long-term debt follows (in millions):

	Carrying Amount		Fair Value	
	December 31,		December 31,	
	2020	2019	2020	2019
Senior secured term loan	\$ 1,539.4	\$ 1,434.1	\$ 1,533.4	\$ 1,434.1
6.750% senior unsecured notes due 2025	\$ 370.0	\$ 370.0	\$ 376.0	\$ 368.2
10.000% senior unsecured notes due 2027	\$ 545.0	\$ 430.0	\$ 596.8	\$ 471.4

The fair values in the table above were based on a Level 2 inputs using quoted prices for identical liabilities in inactive markets. The carrying amounts related to the Company's other long-term debt obligations, including finance lease obligations, approximate their fair values under Level 3 calculations.

The Company has entered into certain interest rate swap agreements (see Note 8. "Derivatives and Hedging Activity"). At December 31, 2020 and 2019, the fair value of these derivative instruments was \$61.0 million and \$50.7 million, respectively, and was included in other long-term liabilities in the consolidated balance sheets. The fair value of these derivative financial instruments was based on a quoted market price, or a Level 2 input.

Revenues

The Company's revenues generally relate to contracts with patients in which the performance obligations are to provide health care services. The Company recognizes revenues in the period in which our obligations to provide health care services are satisfied and reports the amount that reflects the consideration the Company expects to be entitled to receive. The contractual relationships with patients, in most cases, also involve a third-party payor (e.g., Medicare, Medicaid and private insurance organizations, including plans offered through the health insurance exchanges) and the transaction prices for the services provided are dependent upon the terms provided by or negotiated with the third-party payors. The payment arrangements with third-party payors for the services provided to the related patients typically specify payments at amounts less than the Company's standard charges. The Company continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms resulting from contract renegotiations and renewals.

A summary of revenues by service type as a percentage of total revenues follows:

	Year Ended December 31,		
	2020	2019	2018
Patient service revenues:			
Surgical facilities revenues	95.3 %	94.1 %	93.6 %
Ancillary services revenues	3.4 %	4.3 %	4.5 %
	98.7 %	98.4 %	98.1 %
Other service revenues:			
Optical services revenues	0.2 %	0.2 %	0.5 %
Other	1.1 %	1.4 %	1.4 %
	1.3 %	1.6 %	1.9 %
Total revenues	100.0 %	100.0 %	100.0 %

Patient service revenues. This revenue is related to charging facility fees in exchange for providing patient care. The fee charged for health care procedures performed in surgical facilities varies depending on the type of service provided, but usually includes all charges for usage of an operating room, a recovery room, special equipment, medical supplies, nursing staff and medications. The fee does not normally include professional fees charged by the patient's surgeon, anesthesiologist or other attending physician, which are billed directly by such physicians to the patient or third-party payor. However, in several surgical facilities, the Company charges for anesthesia services.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Ancillary service revenues include fees for patient visits to the Company's physician practices, pharmacy services and diagnostic tests ordered by physicians.

Patient service revenues are recognized as performance obligations are satisfied. Performance obligations are based on the nature of services provided. Typically, the Company recognizes revenue at a point in time in which services are rendered and the Company has no obligation to provide further patient services. As the Company primarily performs outpatient procedures, performance obligations are generally satisfied same day and revenue is recognized on the date of service.

The Company determines the transaction price based on gross charges for services provided, net of estimated contractual adjustments, discounts from third-party payors. The Company estimates its contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. Changes in estimated contractual adjustments and discounts are recorded in the period of change.

Other service revenues. Optical service revenues consist of handling charges billed to the members of the Company's optical products purchasing organization. The Company's optical products purchasing organization negotiates volume buying discounts with optical products manufacturers. The buying discounts and any handling charges billed to the members of the buying group represent the revenue recognized for financial reporting purposes. The Company satisfies the performance obligation and recognizes revenue when the orders are shipped to members. The Company bases its estimates for sales returns and discounts on historical experience and has not experienced significant fluctuations between estimated and actual return activity and discounts given. The Company sold its optical products purchasing organization on December 31, 2020.

Other revenues include management and administrative service fees derived from the non-consolidated facilities that the Company accounts for under the equity method, management of surgical facilities in which it does not own an interest, and management services provided to physician practices for which the Company is not required to provide capital or additional assets. These agreements typically require the Company to provide recurring management services over a multi-year period which are billed and collected on a monthly basis. The fees derived from these management arrangements are based on a predetermined percentage of the revenues of each facility or practice and are recognized in the period in which management services are rendered and billed.

The following table sets forth patient service revenues by type of payor and as a percentage of total patient service revenues for the Company's consolidated surgical facilities (dollars in millions):

	Year Ended December 31,					
	2020		2019		2018	
	Amount	%	Amount	%	Amount	%
Patient service revenues:						
Private insurance	\$ 989.9	53.9 %	\$ 970.5	53.8 %	\$ 948.9	54.6 %
Government	708.5	38.6 %	701.9	38.9 %	653.3	37.6 %
Self-pay	58.5	3.2 %	46.1	2.6 %	50.0	2.9 %
Other ⁽¹⁾	79.2	4.3 %	84.6	4.7 %	84.8	4.9 %
Total patient service revenues	1,836.1	100.0 %	1,803.1	100.0 %	1,737.0	100.0 %
Other service revenues:						
Optical service revenues	3.0		3.8		9.5	
Other revenues	21.0		24.5		25.0	
Total revenues	<u>\$ 1,860.1</u>		<u>\$ 1,831.4</u>		<u>\$ 1,771.5</u>	

(1) Other is comprised of anesthesia service agreements, auto liability, letters of protection and other payor types.

Cash, Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Company maintains its cash and cash equivalent balances at high credit quality financial institutions.

Cash, cash equivalents and restricted cash reported within the consolidated statement of cash flows includes \$0.3 million of restricted investments, which are reflected in other long-term assets in the consolidated balance sheet at both December 31, 2020 and 2019. These restricted investments represent restricted cash held in accordance with the provisions of a long-term operating lease agreement held as security for performance under the Company's covenants and obligations within the agreement through January 2024.

Accounts Receivable

Accounts receivable from third-party payors are recorded net of estimated implicit price concessions, which are estimated based on the historical trend of the Company's surgical hospitals' cash collections and contractual write-offs, and for the Company's surgical facilities in general, established fee schedules, relationships with payors and procedure statistics. While changes in estimated reimbursement from

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

third-party payors remain a possibility, the Company expects that any such changes would be minimal and, therefore, would not have a material effect on its financial condition or results of operations.

Accounts receivable consists of receivables from federal and state agencies (under the Medicare and Medicaid programs), private insurance organizations, employers and patients. Management recognizes that revenues and receivables from government agencies are significant to the Company's operations, but it does not believe that there is significant credit risk associated with these government agencies. Concentration of credit risk with respect to other payors is limited because of the large number of such payors.

The Company recognizes that final reimbursement of accounts receivable is subject to final approval by each third-party payor. However, because the Company has contracts with its third-party payors and also verifies insurance coverage of the patient before medical services are rendered, the amounts that are pending approval from third-party payors are not considered significant. Amounts are classified outside of self-pay if the Company has an agreement with the third-party payor or has verified a patient's coverage prior to services rendered. The Company's policy is to collect co-payments and deductibles prior to providing medical services. Patient services of the Company are primarily non-emergency, which allows the surgical facilities to control the procedures for which third-party reimbursement is sought and obtained. The Company does not require collateral from self-pay patients.

The Company's collection policies and procedures are based on the type of payor, size of claim and estimated collection percentage for each patient account. The Company analyzes accounts receivable at each of its surgical facilities to ensure the proper collection and aged category. Collection efforts include direct contact with third-party payors or patients, written correspondence and the use of legal or collection agency assistance, as required.

Prior to its sale on December 31, 2020, the receivables related to the Company's optical products purchasing organization were recognized separately from patient accounts receivable and included in other current assets in the consolidated balance sheets. Such receivables were \$8.6 million at December 31, 2019.

Impairment of Long-Lived Assets, Goodwill and Intangible Assets

The Company evaluates the carrying value of long-lived assets when impairment indicators are present or when circumstances indicate that impairment may exist. The Company performs an impairment test by preparing an expected undiscounted cash flow projection. If the projection indicates that the recorded amount of the long-lived asset is not expected to be recovered, the carrying value is reduced to estimated fair value. The cash flow projection and fair value represents management's best estimate, using appropriate and customary assumptions, projections and methodologies, at the date of evaluation. For discussion on impairment for goodwill and indefinite-lived intangible assets, refer to Note 4. "Goodwill and Intangible Assets."

Professional and General and Workers' Compensation Insurance

The Company maintains general liability and professional liability insurance in excess of self-insured retentions through third party commercial insurance carriers in amounts that management believes is sufficient for the Company's operations, although, potentially, some claims may exceed the scope of coverage in effect. The professional liability insurance coverage is on a claims-made basis and the general liability insurance is on an occurrence basis. The Company also maintains workers' compensation insurance, subject to a self-insured retention.

The Company expenses the costs under the self-insured retention exposure for general and professional liability and workers' compensation claims which relate to (i) claims made during the policy period, which are offset by insurance recoveries and (ii) an estimate of claims incurred but not yet reported that are expected to be reported after the policy period expires. Reserves and provisions are based upon actuarially determined estimates using individual case-basis valuations and actuarial analysis. Reserves for professional, general and workers' compensation claim liabilities are determined with no regard for expected insurance recoveries and are presented gross on the consolidated balance sheets.

Derivative Instruments and Hedging Activities

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

The Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Investments in Unconsolidated Affiliates

Investments in unconsolidated affiliates in which the Company exerts significant influence but does not control or otherwise consolidate are accounted for using the equity method. Equity method investments are initially recorded at cost, unless the investments are a result of the Company losing control of a previously controlled entity, but still retaining a non-controlling interest. Transactions that result in the deconsolidation of a previously consolidated entity, are measured at fair value. The fair value measurement utilizes Level 3 inputs,

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

which include unobservable data, to measure the fair value of the retained non-controlling interest. The fair value determination is generally based on a combination of multiple valuation methods, which can include discounted cash flow, income approach, or market value approach which incorporates estimates of future earnings and market valuation multiples for certain guideline companies. These investments are included as investments in and advances to affiliates in the accompanying consolidated balance sheets. The Company's share of the profits and losses from these investments is reported in income from equity investments in the accompanying consolidated statements of operations. The Company monitors its investments for other-than-temporary impairment by considering factors such as current economic and market conditions and the operating performance of the investees and records reductions in carrying values when necessary.

Non-Controlling Interests

The physician limited partners and physician minority members of the entities that the Company controls are responsible for the supervision and delivery of medical services. The governance rights of limited partners and minority members are restricted to those that protect their financial interests. Under certain partnership and operating agreements governing these partnerships and limited liability companies, the Company could be removed as the sole general partner or managing member for certain events such as material breach of the partnership or operating agreement, gross negligence or bankruptcy. These protective rights do not preclude consolidation of the respective partnerships and limited liability companies.

Ownership interests in consolidated subsidiaries held by parties other than the Company are identified and generally presented in the consolidated financial statements within the equity section but separate from the Company's equity. However, in instances in which certain redemption features that are not solely within the control of the Company are present, classification of non-controlling interests outside of permanent equity is required. Consolidated net income attributable to the Company and to the non-controlling interests are identified and presented on the consolidated statements of operations; changes in ownership interests in which the Company retains a controlling interest are accounted for as equity transactions assuming the Company continues to consolidate related entities. Certain transactions with non-controlling interests are classified within financing activities in the consolidated statements of cash flows.

The consolidated financial statements of the Company include all assets, liabilities, revenues and expenses of surgical facilities in which the Company has sufficient ownership and rights to allow the Company to consolidate the surgical facilities. Similar to its investments in non-consolidated affiliates, the Company regularly engages in the purchase and sale of ownership interests with respect to its consolidated subsidiaries that do not result in a change of control.

Non-Controlling Interests — Redeemable. Each partnership and limited liability company through which the Company owns and operates its surgical facilities is governed by a partnership or operating agreement, respectively. In certain circumstances, the applicable partnership or operating agreements for the Company's surgical facilities provide that the facilities will purchase all of the physician limited partners' or physician minority members', as applicable, ownership if certain adverse regulatory events occur, such as it becoming illegal for the physician(s) to own an interest in a surgical facility, refer patients to a surgical facility or receive cash distributions from a surgical facility. The non-controlling interests—redeemable are reported outside of stockholders' equity in the consolidated balance sheets.

A summary of activity related to the non-controlling interests—redeemable for the years ended December 31, 2020 and 2019 is as follows (in millions):

	December 31,	
	2020	2019
Balance at beginning of period	\$ 321.0	\$ 326.6
Net income attributable to non-controlling interests—redeemable	31.7	39.1
Acquisition and disposal of shares of non-controlling interests, net—redeemable	(9.4)	(4.7)
Distributions to non-controlling interest —redeemable holders	(36.5)	(40.0)
Balance at end of period	<u>\$ 306.8</u>	<u>\$ 321.0</u>

Inventories

Inventories, which consist primarily of medical and drug supplies, are stated at the lower of cost or market value. Cost is determined using the first-in, first-out method.

Recent Accounting Pronouncements

In March 2020, the FASB issued Accounting Standards Update ("ASU") 2020-04 *Reference Rate Reform (Topic 848)*. ASU 2020-04 contains practical expedients for reference rate reform related activities that impact debt, leases, derivatives and other contracts. The guidance in ASU 2020-04 is optional and may be elected over time as reference rate reform activities occur. During the year ended December 31, 2020, the Company elected to apply the hedge accounting expedients related to probability and the assessments of effectiveness for future London Interbank Offered Rate ("LIBOR") indexed cash flows to assume that the index upon which future hedged transactions will be based matches the index on the corresponding derivatives. Application of these expedients preserves the presentation of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

derivatives consistent with past presentation. The Company continues to evaluate the impact of the guidance and may apply other elections as applicable as additional changes in the market occur.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses*, which introduced a new model for recognizing credit losses on financial instruments based on an estimate of the current expected credit losses. The new current expected credit losses ("CECL") model generally calls for the immediate recognition of all expected credit losses and applies to financial instruments and other assets, which is primarily applicable to accounts receivable for the Company. This ASU was effective for the Company on January 1, 2020. The adoption of this ASU did not have a material impact on its consolidated financial position and results of operations.

In February 2016, the FASB issued ASU 2016-02, "Leases" (the "Lease Accounting Standard"). The Company adopted the Lease Accounting Standard effective January 1, 2019, using a modified retrospective transition approach. The most prominent of the changes resulting from this ASU is the recognition of right-of-use assets and lease liabilities by lessees for those leases classified as operating leases. The Company's accounting for finance leases remained substantially unchanged from its prior accounting for capital leases. Upon adoption of the Lease Accounting Standard, the Company recorded \$294.0 million of operating lease liabilities and right-of-use assets on January 1, 2019. The cumulative effect of the accounting change recognized upon adoption was \$6.1 million reflected as an adjustment to retained deficit in our consolidated balance sheets.

2. Acquisitions and Disposals

The Company accounts for business combinations in accordance with the fundamental requirements of the acquisition method of accounting and under the premise that an acquirer can be identified for each business combination. The acquirer is the entity that obtains control of one or more businesses in the business combination and the acquisition date is the date the acquirer achieves control. The assets acquired, liabilities assumed and any non-controlling interests in the acquired business at the acquisition date are recognized at their fair values as of that date, and the direct costs incurred in connection with the business combination are recorded and expensed separately from the business combination. Any goodwill recognized is determined as the excess of the fair value of the consideration conveyed plus the fair value of any non-controlling interests in the acquisition over the fair value of the net assets acquired. Acquisitions in which the Company is able to exert significant influence but does not have control are accounted for using the equity method.

Acquired assets and assumed liabilities typically include, but are not limited to, fixed assets, intangible assets and right-of-use leases. The valuations are based on appraisal reports, discounted cash flow analyses, actuarial analyses or other appropriate valuation techniques to determine the fair value of the assets acquired or liabilities assumed. Fair value attributable to non-controlling interests is based on a Level 3 computation using significant inputs that are not observable in the market. Key inputs used to determine the fair value include financial multiples used in the purchase of non-controlling interests, primarily from acquisitions of surgical facilities. Such multiples, based on earnings, are used as a benchmark for the discount to be applied for the lack of control or marketability. Fair value attributable to the property and equipment acquired is based on Level 3 computations using key inputs such as cost trend data and comparable asset sales. Fair value attributable to the intangible assets acquired is based on Level 3 computations using key inputs such as the Company's internally-prepared financial projections. Fair values assigned to acquired working capital are based on carrying amounts reported by the acquiree at the date of acquisition, which approximate their fair values.

Acquisitions

During the year ended December 31, 2020, the Company acquired a controlling interest in three surgical facilities, including a surgical hospital, a controlling interest in five surgical facilities in existing markets, that were merged into existing facilities and a physician practice for total aggregate consideration of \$120.1 million, including cash consideration of \$104.6 million, net of cash acquired, non-cash consideration of \$8.7 million and contingent consideration of \$0.7 million. The non-cash consideration consisted of non-controlling interests in the Company's existing surgical facilities. The cash consideration was funded through cash from operations, proceeds from its recent divestitures and other available resources. The total consideration was allocated to the assets acquired and liabilities assumed based upon the respective acquisition date fair values.

During the year ended December 31, 2019, the Company acquired a controlling interest in one surgical facility, a clinic that was merged into an existing facility and a physician practice for total aggregate consideration of \$26.7 million, including cash consideration of \$20.1 million, net of cash acquired. The remainder of the consideration related to the forgiveness of certain amounts due to the Company from the acquired clinic. During 2020, the Company made a working capital settlement payment resulting in additional cash consideration of \$0.8 million related to the clinic acquisition. The additional consideration is reflected in the table below. During the year ended December 31, 2020, no other significant changes were made to the purchase price allocation of assets and liabilities, existing at the date of acquisition, related to individual acquisitions completed in 2019.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Preliminary or final amounts recognized for each major class of assets acquired and liabilities assumed for acquisitions completed during the years ended December 31, 2020 and 2019, including post acquisition date adjustments, are as follows (in millions):

	<u>2020</u>	<u>2019</u>
Consideration transferred ⁽¹⁾	\$ 120.1	\$ 27.4
Fair value of non-controlling interests	57.3	8.3
Aggregate acquisition date fair value	<u>\$ 177.4</u>	<u>\$ 35.7</u>
Net assets acquired:		
Current Assets	\$ 24.3	\$ 5.4
Property and equipment	50.6	1.8
Intangible assets	3.6	—
Goodwill	153.7	23.4
Right-of-use operating lease assets	15.4	28.8
Other long-term assets ⁽²⁾	0.2	8.9
Current liabilities	(16.4)	(4.2)
Long-term debt	(40.0)	(0.2)
Right-of-use operating lease liabilities	(14.0)	(28.2)
Aggregate acquisition date fair value	<u>\$ 177.4</u>	<u>\$ 35.7</u>

(1) In connection with the clinic acquisition in 2019, the Company acquired the remaining non-controlling interests in one of its existing consolidated surgical facilities. As such, \$6.3 million of the cash consideration for the clinic acquisition was classified as a financing activity and presented in payments related to ownership transactions with non-controlling interest holders in the Consolidated Statements of Cash Flows.

(2) The assets acquired in 2019 includes the fair value of a non-controlling investment held by the acquired clinic in one of the Company's consolidated surgical facilities of \$8.8 million. This investment asset was subsequently eliminated in consolidation.

The fair values assigned to certain assets acquired and liabilities assumed by the Company in 2020 have been estimated on a preliminary basis and are subject to change as new facts and circumstances emerge that were present at the date of acquisition. The goodwill acquired in connection with the 2020 acquisitions was allocated to the Company's Surgical Facility Services reportable segment. The results of operations of the 2020 acquisitions are included in the Company's results of operations beginning on the dates of acquisition, and were not considered significant for the year ended December 31, 2020.

During the year ended December 31, 2019, the Company acquired non-controlling interests, primarily in four surgical facilities, for a cash investment of \$15.2 million. The non-controlling interests were accounted for as equity method investments.

Disposals

During the year ended December 31, 2020, the Company sold its interests in three surgery centers, one of which was previously accounted for as an equity method investment, sold certain assets related to its anesthesia business, certain imaging assets and its optical products purchasing organization for combined net cash proceeds of \$58.5 million, and recognized a net pre-tax gain of \$5.2 million included in loss on disposals and deconsolidations, net in the consolidated statement of operations for the year ended December 31, 2020. Additionally, the Company closed its diagnostic laboratory and recognized a net pre-tax loss of \$3.5 million included in loss on disposals and deconsolidations, net in the consolidated statement of operations for the year ended December 31, 2020.

During the year ended December 31, 2019, the Company disposed of previously owned real property associated with one of its existing non-consolidated surgical facilities. In connection with the sale, the Company recognized a \$10.9 million pretax gain included in loss (gain) on disposals and deconsolidations, net in the accompanying consolidated statements of operations. The sale did not impact the Company's investment in the surgical facility, which continues to be accounted for as an equity method investment.

During the year ended December 31, 2018, the Company disposed of four surgery centers, two surgical hospitals and its optical laboratory for net cash proceeds of \$18.7 million, and recognized a net pretax loss of \$21.2 million included in loss on disposals and deconsolidations, net in the consolidated statement of operations for the year ended December 31, 2018. The non-cash loss was primarily a result of the write-off of the net assets of the facility (net of proceeds received) and was primarily driven by the write-off of the associated goodwill.

3. Property and Equipment

Property and equipment are stated at cost or, if obtained through acquisition, at fair value determined on the date of acquisition. Depreciation is recognized using the straight-line method over the estimated useful lives of the assets, generally 20 to 40 years for buildings

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

and building improvements, three to five years for computers and software and five to seven years for furniture and equipment. Leasehold improvements are depreciated on a straight-line basis over the shorter of the lease term or the estimated useful life of the assets. Routine maintenance and repairs are expensed as incurred, while expenditures that increase capacities or extend useful lives are capitalized.

The Company also leases certain facilities and equipment under finance leases. Assets held under finance leases are stated at the present value of lease payments at the inception of the related lease. Such assets are amortized on a straight-line basis over the lesser of the lease term or the remaining useful life of the leased asset.

A summary of property and equipment follows (in millions):

	December 31,	
	2020	2019
Land	\$ 11.1	\$ 11.0
Buildings and improvements	109.7	106.6
Furniture and equipment	20.7	23.1
Computer and software	80.8	59.8
Medical equipment	196.8	148.3
Right-of-use finance lease asset	298.4	259.3
Construction in progress	16.4	25.9
Property and equipment, at cost	733.9	634.0
Less: Accumulated depreciation	(189.3)	(110.7)
Property and equipment, net	<u>\$ 544.6</u>	<u>\$ 523.3</u>

Depreciation expense was \$90.5 million, \$71.9 million and \$62.5 million for the years ended December 31, 2020, 2019 and 2018, respectively.

4. Goodwill and Intangible Assets

Goodwill represents the fair value of the consideration provided in an acquisition over the fair value of net assets acquired and is not amortized. The Company has indefinite-lived intangible assets related to the certificates of need held in jurisdictions where certain of its surgical facilities are located, Medicare licenses and certain management rights agreements. The Company also has finite-lived intangible assets related to physician guarantee agreements, non-compete agreements, management rights agreements and customer relationships. Physician income guarantees are amortized into salaries and benefits costs in the consolidated statements of operations over the commitment period of the contract, generally three to four years. Non-compete agreements and management rights agreements are amortized into depreciation and amortization expense in the consolidated statements of operations over the service lives of the agreements, typically ranging from two to five years for non-compete agreements and 15 years for the management rights agreements. Customer relationships are amortized into depreciation and amortization expense in the consolidated statements of operations over the estimated lives of the relationships, ranging from three to ten years.

The Company tests its goodwill and indefinite-lived intangible assets for impairment at least annually, as of October 1, or more frequently if certain indicators arise. The Company tests for goodwill impairment at the reporting unit level, which is defined as one level below an operating segment. During 2020, the Company identified three reporting units, which include the following: 1) Surgical Facilities, 2) Ancillary Services, and 3) Alliance, which is a component of the Optical Services operating segment. A detailed evaluation of potential impairment indicators was performed, which specifically considered the volatility observed in the prices of the Company's outstanding debt securities and common stock, as well as the decline in surgical case volumes following the emergence of the COVID-19 pandemic, all of which improved in the second half of 2020 as states began to re-open and allow for non-emergent procedures.

The Company compares the carrying value of the net assets of the reporting unit to the estimated fair value of the reporting unit. To determine the fair value of the reporting units, the Company obtained valuations at the reporting unit level prepared by third-party valuation specialists which typically utilizes a combination of the income and market approaches. The discounted cash flow model is projected based on a year-by-year assessment that considers historical results, estimated market conditions, internal projections, and relevant publicly available statistics. Determining fair value requires the exercise of significant judgment, including assumptions about appropriate discount rates, perpetual growth rates and the amount and timing of expected future cash flows. The significant judgments are typically based upon Level 3 inputs, generally defined as unobservable inputs representing the Company's own assumptions. The cash flows employed in the discounted cash flow analysis are based on the Company's most recent budgets and business plans aligned with provided guidance and, when applicable, various growth rates are assumed for years beyond the current business plan period. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. The variables within the discount rate, many of which are outside of the Company's control, provide the best estimate of all assumptions applied within the discounted cash flow model. There can be no assurance that operations will achieve the future cash flows reflected in the projections. In determining the fair value under the market approaches, the analysis includes a control premium, which was based on observable market data and a review of selected

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

transactions of companies that operate in the Company's sector. While the Company believes that all assumptions utilized in the testing were appropriate, they may not reflect actual outcomes that could occur. Specific factors that could negatively impact the assumptions used include changes to the discount and growth rates and a change in the equity and enterprise premiums being realized in the market.

On the basis of available evidence as of August 31, 2020, the Company identified indicators of impairment related to its Ancillary Services and Alliance reporting units, including the impacts of the COVID-19 pandemic, the closure of its diagnostic laboratory (as discussed in Note 2. "Acquisitions and Disposals") and its strategic decision to sell its optical products purchasing organization. No indicators of impairment were identified for the Company's Surgical Facilities reporting unit. Based on the impairment indicators noted, the Company performed an impairment analysis for the Ancillary Services and Alliance reporting units as of August 31, 2020. As of the September 30, 2020 valuation, carrying value for both the Ancillary Services and Alliance reporting units exceeded the fair value, resulting in non-cash impairment charges of \$28.6 million and \$4.9 million, respectively. The fair values as of August 31, 2020 were determined using the adjusted book value for the Ancillary Services reporting unit and the discounted cash flow model for the Alliance reporting unit.

As of October 1, 2020, prior to its annual impairment testing, the Company's three reporting units with allocated goodwill were as follows: 1) Surgical Facilities - \$3.3 billion, 2) Ancillary Services - no remaining goodwill after the August 31 impairment discussed above, and 3) Alliance - \$4.2 million. As of the October 1, 2020 valuation, the fair value for the Surgical Facilities reporting unit was substantially in excess of its carrying value, and there were no additional indicators of impairment related to the other reporting units. The fair value of the Surgical Facilities reporting unit as of October 1, 2020 was determined using the income and market approach as discussed above.

Subsequent to the date of our annual impairment test, the Company considered its operating results for the fourth quarter of 2020, macroeconomic, industry and market conditions, and other market indicators including its market capitalization. Based on its evaluation of all such factors, the Company concluded that an event had not occurred or circumstances had not changed that would more likely than not reduce the fair value of its reporting units below their carrying values. On December 31, 2020, the Company disposed of the Alliance reporting unit with the sale of its optical products purchasing organization.

During the year ended December 31, 2019, as a result of its impairment testing, the Company recorded non-cash impairment charges of \$2.5 million related to the Alliance reporting unit.

During the year ended December 31, 2018, as a result of its impairment testing, the Company recorded non-cash impairment charges of \$60.7 million and \$13.7 million related to the Ancillary Services and Alliance reporting units, respectively.

A summary of the changes in the carrying amount of goodwill follows (in millions):

	December 31,	
	2020	2019
Balance at beginning of period	\$ 3,402.4	\$ 3,382.8
Acquisitions, including post acquisition adjustments	154.7	22.3
Disposals and deconsolidations	(55.6)	(0.2)
Impairments	(33.5)	(2.5)
Balance at end of period	<u>\$ 3,468.0</u>	<u>\$ 3,402.4</u>

A summary of the Company's acquisitions and disposals for the years ended December 31, 2020 and 2019 is included in Note 2. "Acquisitions and Disposals."

A summary of the components of intangible assets follows (in millions):

	December 31, 2020			December 31, 2019		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Finite-lived intangible assets:						
Management rights agreements	\$ 31.1	\$ (10.1)	\$ 21.0	\$ 31.1	\$ (7.3)	\$ 23.8
Other	13.6	(6.5)	7.1	8.8	(4.5)	4.3
Total finite-lived intangible assets	44.7	(16.6)	28.1	39.9	(11.8)	28.1
Indefinite-lived intangible assets	18.8	—	18.8	19.2	—	19.2
Total intangible assets	<u>\$ 63.5</u>	<u>\$ (16.6)</u>	<u>\$ 46.9</u>	<u>\$ 59.1</u>	<u>\$ (11.8)</u>	<u>\$ 47.3</u>

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

During the year ended December 31, 2019, the Company acquired a clinic that was previously managed by the Company. As a result of the transaction, the Company determined the management rights agreement related to the acquired clinic no longer provided a future benefit. As such, the Company recorded non-cash impairment charges of \$5.4 million, which was included as a component of impairment charges on the accompanying consolidated statement of operations.

Amortization expense for intangible assets was \$4.3 million, \$4.6 million and \$4.9 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Total estimated amortization expense for the next five years and thereafter related to intangible assets follows (in millions):

2021	\$	5.7
2022		3.8
2023		2.9
2024		2.5
2025		1.9
Thereafter		11.3
Total	\$	28.1

5. Long-Term Debt

A summary of long-term debt follows (in millions):

	December 31,	
	2020	2019
Senior secured term loan ⁽¹⁾	\$ 1,539.4	\$ 1,434.1
Senior secured revolving credit facility	—	—
6.750% senior unsecured notes due 2025	370.0	370.0
10.000% senior unsecured notes due 2027	545.0	430.0
Notes payable and other secured loans	137.5	104.0
Finance lease obligations	281.2	253.4
Less: unamortized debt issuance costs	(16.3)	(10.8)
Total debt	2,856.8	2,580.7
Less: Current maturities	64.4	56.0
Total long-term debt	\$ 2,792.4	\$ 2,524.7

(1) Includes unamortized fair value discount of \$3.7 million and \$4.6 million as of December 31, 2020 and 2019, respectively.

Senior Secured Credit Facilities

The Company has a credit agreement (the "Credit Agreement") providing for a \$1.29 billion senior secured term loan (the "Term Loan"), a \$180.0 million senior secured incremental term loan (the "2018 Incremental Term Loan"), a \$120.0 million senior secured incremental term loan (the "2020 Incremental Term Loan") and a \$120.0 million senior secured revolving credit facility (the "Revolver" and, together with the Term Loan, the 2018 Incremental Term Loan and the 2020 Incremental Term Loan, the "Senior Secured Credit Facilities"). The Revolver may be utilized for working capital, capital expenditures and general corporate purposes. Subject to certain conditions and requirements set forth in the Credit Agreement, the Company may request one or more additional incremental term loan facilities or one or more increases in the commitments under the Revolver. On March 18, 2020, the Company drew down its available capacity under its Revolver, as a precautionary measure in order to increase liquidity and preserve financial flexibility in light of current uncertainty resulting from the COVID-19 pandemic. During the second quarter, the Company fully repaid the outstanding balance. As of both December 31, 2020 and 2019, the Company had no outstanding borrowing on the Revolver. As of December 31, 2020, the Company's availability on the Revolver was \$112.5 million (including outstanding letters of credit of \$7.5 million).

The Term Loan will mature on August 31, 2024 and the Revolver will mature on August 31, 2022. The Senior Secured Credit Facilities bear interest at a rate per annum equal to (x) LIBOR plus a margin ranging from 3.00% to 3.25% per annum, depending on the Company's first lien net leverage ratio or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate and (iii) one-month LIBOR plus 1.00% per annum (solely with respect to the Term Loan, the alternate base rate shall not be less than 2.00% per annum)) plus a margin ranging from 2.00% to 2.25% per annum. In addition, the Company is required to pay a commitment fee of 0.50% per annum in respect of unused commitments under the Revolver.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Term Loan amortizes in equal quarterly installments of 0.25% of the aggregate original principal amount of the Term Loan. The Term Loan is subject to mandatory prepayments based on excess cash flow for the applicable fiscal year that will depend on the first lien net leverage ratio as of the last day of the applicable fiscal year, as well as upon the occurrence of certain other events, as described in the Credit Agreement. There were no excess cash flow payments required as of December 31, 2020.

On April 22, 2020, the Company entered into a second incremental term loan amendment, which further amended and supplemented the Credit Agreement to provide for a \$120.0 million senior secured incremental term loan. The 2020 Incremental Term Loans were fully drawn on April 22, 2020 and bear interest at a rate per annum equal to (x) LIBOR plus a margin of 8.00% per annum or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate, (iii) one-month LIBOR plus 1.00% per annum and (iv) 2.00% per annum) plus a margin of 7.00% per annum. The 2020 Incremental Term Loans were incurred as a separate tranche of term loans under the Credit Agreement, and are subject to maturity, amortization and mandatory prepayment provisions consistent with the existing terms loans outstanding under the Credit Agreement. Voluntary prepayments of the 2020 Incremental Term Loans are permitted, in whole or in part, with prior notice, without premium or penalty (except LIBOR breakage costs and a make-whole and call premium, as applicable, in the case of certain prepayments or events within a specified period of time after April 22, 2020, as set forth in the second incremental term loan amendment).

With respect to the Revolver, the Company is required to comply with a maximum consolidated total net leverage ratio of 9.50:1.00, which covenant will be tested quarterly on a trailing four quarter basis only if, as of the last day of the applicable fiscal quarter the Revolver is drawn in an aggregate amount greater than 35% of the total commitments under the Revolver. Such financial maintenance covenant is subject to an equity cure. The Credit Agreement includes customary negative covenants restricting or limiting the ability of the Company and its restricted subsidiaries, to, among other things, sell assets, alter its business, engage in mergers, acquisitions and other business combinations, declare dividends or redeem or repurchase equity interests, incur additional indebtedness or guarantees, make loans and investments, incur liens, enter into transactions with affiliates, prepay certain junior debt, and modify or waive certain material agreements and organizational documents, in each case, subject to customary and other agreed upon exceptions. The Credit Agreement also contains customary affirmative covenants and events of default. On April 16, 2020, the Company entered into a third amendment to Credit Agreement governing the Revolver, which amended and supplemented financial covenants applicable to the Revolver. Pursuant to the third amendment, the Company's requirement to comply with a maximum consolidated total net leverage ratio was waived for the remainder of 2020. Additionally, for the first three quarters of 2021, the third amendment provides for an alternative calculation for the maximum consolidated total net leverage ratio where the trailing four quarter basis may be negatively impacted by the impacts of the COVID-19 pandemic. The third amendment became effective concurrently with the funding of the 2020 Incremental Term Loans on April 22, 2020, and are discussed in more detail above. As of December 31, 2020, the Company was in compliance with the covenants contained in the Credit Agreement.

The Senior Secured Credit Facilities are guaranteed, on a joint and several basis, by SP Holdco I, Inc. and each of Surgery Center Holdings, Inc.'s current and future wholly-owned domestic restricted subsidiaries (subject to certain exceptions) (the "Subsidiary Guarantors") and are secured by a first priority security interest in substantially all of Surgery Center Holdings, Inc.'s, SP Holdco I, Inc.'s and the Subsidiary Guarantors' assets (subject to certain exceptions).

In connection with the 2020 Incremental Term Loans borrowings, the Company recorded debt issuance costs and discount of \$6.5 million.

6.750% Senior Unsecured Notes due 2025

Effective June 30, 2017, the Company issued \$370.0 million in gross proceeds of senior unsecured notes due July 1, 2025 (the "2025 Unsecured Notes"). The 2025 Unsecured Notes bear interest at the rate of 6.750% per year, payable semi-annually on January 1 and July 1 of each year. The 2025 Unsecured Notes are a senior unsecured obligation of Surgery Center Holdings, Inc. and are guaranteed on a senior unsecured basis by each of Surgery Center Holdings, Inc.'s existing and future domestic wholly-owned restricted subsidiaries that guarantees the Senior Secured Credit Facilities (subject to certain exceptions).

The Company may redeem the 2025 Unsecured Notes, in whole or in part, at any time on or after July 1, 2020, at the redemption prices set forth below (expressed as a percentage of the principal amount to be redeemed), plus accrued and unpaid interest, if any, up to, but excluding, the date of redemption:

July 1, 2020 to June 30, 2021	103.375 %
July 1, 2021 to June 30, 2022	101.688 %
July 1, 2022 and thereafter	100.000 %

If Surgery Center Holdings, Inc. experiences a change in control under certain circumstances, it must offer to purchase the 2025 Unsecured Notes at a purchase price equal to 101.000% of the principal amount, plus accrued and unpaid interest, if any, up to, but excluding, the date of repurchase.

The 2025 Unsecured Notes contain customary affirmative and negative covenants, which, among other things, limit the Company's ability to incur additional debt, pay dividends, create or assume liens, effect transactions with its affiliates, guarantee payment of certain debt securities, sell assets, merge, consolidate, enter into acquisitions and effect sale and leaseback transactions.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10.000% Senior Unsecured Notes due 2027

Effective April 11, 2019, the Company issued \$430.0 million in an aggregate principal amount of senior unsecured notes due April 15, 2027 (the "2027 Unsecured Notes"). The 2027 Unsecured Notes bear interest at the rate of 10.000% per annum, payable semi-annually on April 15 and October 15 of each year, beginning on October 15, 2019. The 2027 Unsecured Notes are a senior unsecured obligation of Surgery Center Holdings, Inc. and are guaranteed on a senior unsecured basis by each of Surgery Center Holdings, Inc.'s existing and future domestic wholly-owned restricted subsidiaries that guarantees the Senior Secured Credit Facilities (subject to certain exceptions).

The Company may redeem up to 40% of the aggregate principal amount of the 2027 Unsecured Notes at any time prior to April 15, 2022, with the net cash proceeds of certain equity issuances at a redemption price equal to 110.000% of the principal amount of notes to be redeemed, plus accrued and unpaid interest to, but excluding, the date of redemption.

The Company may redeem the 2027 Unsecured Notes, in whole or in part, at any time prior to April 15, 2022, at a redemption price equal to 100% of the principal amount of notes to be redeemed plus the applicable premium, plus accrued and unpaid interest, if any, to, but excluding, the date of redemption. The Company may redeem the 2027 Unsecured Notes, in whole or in part, at any time on or after April 15, 2022, at the redemption prices set forth below (expressed as a percentage of the principal amount of notes to be redeemed), plus accrued and unpaid interest, if any, up to, but excluding, the date of redemption:

April 15, 2022 to April 14, 2023	105.000 %
April 15, 2023 to April 14, 2024	102.500 %
April 15, 2024 and thereafter	100.000 %

If Surgery Center Holdings, Inc. experiences a change of control under certain circumstances, it must offer to purchase the 2027 Unsecured Notes at a purchase price equal to 101.000% of the aggregate principal amount of notes, plus accrued and unpaid interest, if any, up to, but excluding, the date of repurchase.

The indenture governing the 2027 Unsecured Notes contains customary affirmative and negative covenants, which, among other things, limit the Company's ability to incur additional debt, pay dividends, create or assume liens, effect transactions with its affiliates, guarantee payment of certain debt securities, sell assets, merge, consolidate, enter into acquisitions and effect sale and leaseback transactions.

On July 30, 2020, the Company completed the issuance and sale of \$115.0 million in aggregate principal amount of senior unsecured notes due 2027 at 100.75% of the principal amount. The notes were issued as part of the same series as the existing 2027 Unsecured Notes originally issued in April 2019, and have the same terms. In connection with the notes issuance, the Company recorded debt issuance costs, net of issuance premium of \$1.0 million.

Other Debt

Certain of the Company's subsidiaries have outstanding indebtedness under notes payable and other secured loans, which is collateralized by the real estate and equipment owned by the surgical facilities to which the loans were made, and right-of-use finance lease obligations for which the Company is liable to various vendors for several property and equipment leases classified as finance leases. The various bank indebtedness agreements contain covenants to maintain certain financial ratios and also restrict encumbrance of assets, creation of indebtedness, investing activities and payment of distributions. At December 31, 2020, the Company was in compliance with its covenants contained in the credit agreements.

Maturities

A summary of maturities for the Company's long-term debt, excluding unamortized debt issuance costs and the unamortized fair value discount discussed above, for the next five years and thereafter as of December 31, 2020 follows (in millions):

2021	\$ 64.4
2022	57.1
2023	53.4
2024	1,519.7
2025	396.7
Thereafter	785.5
Total	<u>\$ 2,876.8</u>

6. Leases

The Company determines if an arrangement is a lease at inception. Right-of-use assets represent the right to use the underlying assets for the lease term and the lease liabilities represent the obligation to make lease payments arising from the leases. Right-of-use assets and liabilities are recognized at commencement date based on the present value of future lease payments over the lease term, which includes

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

only payments that are fixed and determinable at the time of commencement. When readily determinable, the Company uses the interest rate implicit in a lease to determine the present value of future lease payments. For leases where the implicit rate is not readily determinable, the Company's incremental borrowing rate is used. The Company calculates its incremental borrowing rate on a periodic basis using a third-party financial model that estimates the rate of interest the Company would have to pay to borrow an amount equal to the total lease payments on a collateralized basis over a term similar to the lease. The Company applies its incremental borrowing rate using a portfolio approach. The right-of-use asset also includes any lease payments made prior to commencement and is recorded net of any lease incentives received. Lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise such options.

The Company's operating leases are primarily for real estate, including medical office buildings, and corporate and other administrative offices. The Company's finance leases are primarily for medical equipment and information technology and telecommunications assets. The Company's finance leases also include certain land, buildings and improvements as discussed in Note 3. "Property and Equipment." Real estate lease agreements typically have initial terms of ten years and may include one or more options to renew. Certain leases also include options to purchase the leased property. The useful life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise. The majority of the Company's medical equipment leases have a bargain purchase option that is reasonably certain of exercise, so these assets are depreciated over their useful life. The Company's lease agreements do not contain any material residual value guarantees, restrictions or covenants.

Certain of the Company's lease agreements require the Company to pay common area maintenance, repairs, property taxes and insurance costs, which are variable amounts based on actual costs incurred during each applicable period. Certain lease agreements also include escalating rent payments that are not fixed at commencement but are based on an index that is determined in future periods over the lease term based on changes in the Consumer Price Index or other measure of cost inflation. These variable components of lease payments are expensed as incurred and are not included in the determination of the right-of-use asset or lease liability.

Due to the COVID-19 pandemic, the Company received concessions for certain of its leases primarily consisting of deferral of rental payments. The Company has elected to account for these COVID-19 related concessions as though the enforceable rights and obligations for those concessions are explicit within the underlying contract. The Company accounts for the deferred rentals as a component of other current liabilities within the consolidated balance sheets. In a few instances the Company modified the terms of the lease in exchange for lease concessions. These modifications resulted in an increase to the Company's right-of-use operating lease assets and liabilities of \$27.4 million during the year ended December 31, 2020.

The following table presents the components of the Company's right-of-use assets and liabilities related to leases and their classification in the consolidated balance sheets at December 31, 2020 and 2019 (in millions):

	Classification in Consolidated Balance Sheets	December 31, 2020	December 31, 2019
Assets:			
Operating lease assets	Right-of-use operating lease assets	\$ 310.1	\$ 297.7
Finance lease assets	Property and equipment, net of accumulated depreciation	258.1	237.1
Total leased assets		<u>\$ 568.2</u>	<u>\$ 534.8</u>
Liabilities:			
Operating lease liabilities:			
Current	Other current liabilities	\$ 39.2	\$ 37.3
Long-term	Right-of-use operating lease liabilities	300.9	283.1
Total operating lease liabilities		<u>340.1</u>	<u>320.4</u>
Finance lease liabilities:			
Current	Current maturities of long-term debt	18.9	15.8
Long-term	Long-term debt, less current maturities	262.3	237.6
Total finance lease liabilities		<u>281.2</u>	<u>253.4</u>
Total lease liabilities		<u>\$ 621.3</u>	<u>\$ 573.8</u>

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table presents the weighted-average lease terms and discount rates at December 31, 2020 and 2019 (in millions):

	December 31, 2020		December 31, 2019	
	Operating Leases	Finance Leases	Operating Leases	Finance Leases
Weighted-average remaining lease term	8.9 years	15.9 years	8.9 years	16.6 years
Weight average discount rate	10.3 %	9.2 %	10.4 %	8.7 %

The following table presents the components of the Company's lease expense and their classification in the consolidated statement of operations for the years ended December 31, 2020 and 2019 (in millions):

	December 31, 2020	December 31, 2019
Operating lease costs	\$ 74.1	\$ 70.4
Finance lease costs:		
Amortization of leased assets	26.2	22.2
Interest on lease liabilities	22.2	13.0
Total finance lease costs	48.4	35.2
Variable and short-term lease costs	16.9	13.2
Total lease costs	\$ 139.4	\$ 118.8

During the years ended December 31, 2020 and 2019, the Company incurred lease costs of \$22.8 million and \$20.6 million, respectively, under operating lease agreements with physician investors who are related parties. During the years ended December 31, 2020 and 2019, the Company paid rent of \$6.9 million and \$6.7 million, respectively, under a finance lease agreement with a lessor who is a related party. One of the Company's surgical facilities has a non-controlling ownership interest in the lessor. Payments are allocated to principal adjustments of the finance lease liability and interest expense.

The following table presents supplemental cash flow information for the years ended December 31, 2020 and 2019 (dollars in millions):

	December 31, 2020	December 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash outflows from operating leases	\$ 68.1	\$ 67.3
Operating cash outflows from finance leases	\$ 20.7	\$ 13.0
Financing cash outflows from finance leases	\$ 18.3	\$ 13.4
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	\$ 62.1	\$ 56.2
Finance leases	\$ 47.0	\$ 133.3

Future maturities of lease liabilities at December 31, 2020 are presented in the following table (in millions):

	Operating Leases	Finance Leases
2021	\$ 70.7	\$ 43.2
2022	66.1	40.7
2023	62.1	37.0
2024	58.4	32.1
2025	50.0	30.7
Thereafter	219.1	381.9
Total lease payments	526.4	565.6
Less: imputed interest	(186.3)	(284.4)
Total lease obligations	\$ 340.1	\$ 281.2

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. Redeemable Preferred Stock

On August 31, 2017, the Company completed the sale issuance of 310,000 shares of the Company's preferred stock, par value \$0.01 per share, designated as 10.00% Series A Convertible Perpetual Participating Preferred Stock (the "Series A Preferred Stock") to Bain Capital at a purchase price of \$1,000 per share for an aggregate purchase price of \$310.0 million (the "Preferred Private Placement").

The accrued value of the Series A Preferred Stock is convertible into shares of common stock at a price per share of common stock equal to \$19.00, subject to certain adjustments as provided in the Certificate of Designations, Preferences, Rights and Limitations of the 10.00% Series A Convertible Perpetual Participating Preferred Stock of Surgery Partners, Inc. (the "Series A Certificate of Designation"), at any time at the option of the holder. In addition, the Company may require the conversion of all, but not less than all, of the Series A Preferred Stock pursuant to the terms and conditions of the Series A Certificate of Designation, after the second anniversary of the date of issuance, if the volume weighted average closing price of the Common Stock for any 20 out of 30 consecutive trading days prior to such date, equals or exceeds \$42.00 per share.

The Company cannot redeem the Series A Preferred Stock prior to the fifth anniversary of its issuance and thereafter, may redeem all, but not less than all, of the Series A Preferred Stock for cash pursuant to and subject to the terms and conditions of the Series A Certificate of Designation. The holders of Series A Preferred Stock may cause the Company to redeem the Series A Preferred Stock upon the occurrence of certain change of control transactions of the Company or the common stock ceasing to be listed or quoted on a trading market. The Company adjusts the carrying amount of the Series A Preferred Stock to equal the redemption value at the end of each reporting period as if it were also the redemption date. Changes in the redemption value are recognized immediately as they occur.

The Series A Preferred Stock ranks senior to the common stock and any other capital stock of the Company with respect to dividends, redemption and any other rights upon the liquidation, dissolution or winding up of the Company, and the holders thereof are entitled to vote with the holders of common stock, together as a single class, on all matters submitted to a vote of the Company's stockholders. In addition to participating in any dividends that may be declared with respect to the common stock on an as-converted basis, each share of Series A Preferred Stock accrues dividends daily at a dividend rate of 10.00%, compounding quarterly, and in any given quarter, subject to certain conditions, the Board of Directors of the Company may declare a cash dividend in an amount up to 50% of the amount of the dividend that has accrued and accumulated during such quarter through the end of such quarter, and the amount of any quarterly dividend paid in cash shall not compound on the applicable date and shall not be included in the accrued value of the Series A Preferred Stock. In the event of the Company's liquidation, dissolution or winding-up (whether voluntary or involuntary), holders of Series A Preferred Stock will be entitled to receive out of the assets of the Company available for distribution to shareholders, after satisfaction of any liabilities and obligations to creditors of the Company, with respect to each Series A Preferred Share, an amount equal to the greater of (i) \$1,000.00 per share, plus dividends compounded to date, plus dividends accrued but not yet compounded and (ii) the amount that a holder of one share of common stock would receive, assuming the Series A Preferred Stock had converted into shares of common stock.

The following table presents a summary of activity related to the redeemable preferred stock for the years ended December 31, 2020 and 2019 (in millions):

	December 31,	
	2020	2019
Balance at beginning of period	\$ 395.0	\$ 359.3
Dividends accrued (there were no cash dividends declared)	39.5	35.7
Balance at end of period	<u>\$ 434.5</u>	<u>\$ 395.0</u>

There were no unpaid cash dividends declared at December 31, 2020 and 2019. The aggregate and per share amounts of unpaid cumulative preferred dividends as of December 31, 2020 and 2019 were \$109.0 million and \$351.54, and \$69.5 million and \$224.09, respectively.

8. Derivatives and Hedging Activities

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. During 2020 and 2019, such derivatives have been used to hedge the variable cash flows associated with existing variable-rate debt.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in accumulated other comprehensive income ("OCI") and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings, as documented at hedge inception in accordance with the Company's accounting policy election. Amounts reported in accumulated OCI related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. Over the next 12 months, the Company estimates that \$21.8 million will be reclassified as an increase to interest expense.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of December 31, 2020 and 2019, the Company had four interest rate swaps with a current notional amount of \$1.2 billion and a termination date of November 30, 2023. The derivatives are recorded at fair value (see Note 1. "Organization and Summary of Accounting Policies") and classified as a long-term liability included in other long-term liabilities in the consolidated balance sheets as of December 31, 2020 and 2019.

The following table presents the pre-tax effect of the interest rate swaps on the Company's accumulated OCI and statement of operations (in millions):

	Year Ended December 31,		
	2020	2019	2018
Derivatives in cash flow hedging relationships:			
Loss recognized in OCI (effective portion)	\$ 30.5	\$ 35.8	\$ 23.1
Loss reclassified from accumulated OCI to interest expense (effective portion)	20.2	7.5	0.6

9. Earnings Per Share

Basic and diluted earnings per share are calculated based on the weighted-average number of shares outstanding in each period and dilutive stock options, unvested shares and warrants, to the extent such securities exist and have a dilutive effect on earnings per share. The Company computes basic and diluted earnings per share using the two-class method. The two-class method of computing earnings per share is an earnings allocation method that determines earnings per share for common shares and participating securities according to their participation rights in dividends and undistributed earnings.

A reconciliation of the numerator and denominator of basic and diluted earnings per share follows (dollars in millions, except per share amounts; shares in thousands):

	Year Ended December 31,		
	2020	2019	2018
Numerator:			
Net loss attributable to Surgery Partners, Inc.	\$ (116.1)	\$ (74.8)	\$ (205.7)
Less: Amounts allocated to participating securities ⁽¹⁾	(39.5)	(35.7)	(32.4)
Net loss attributable to common stockholders	<u>\$ (155.6)</u>	<u>\$ (110.5)</u>	<u>\$ (238.1)</u>
Denominator:			
Weighted average shares outstanding- basic and diluted ⁽²⁾	48,776	48,280	48,028
Basic and diluted loss per share ⁽²⁾	\$ (3.19)	\$ (2.29)	\$ (4.96)
Dilutive securities outstanding not included in the computation of diluted loss per share as their effect is antidilutive:			
Stock options	712	—	83
Restricted shares	981	67	198

(1) Includes dividends accrued during all periods for the Series A Preferred Stock. The Series A Preferred Stock does not participate in undistributed losses.

(2) The impact of potentially dilutive securities for all periods were not considered because the effect would be anti-dilutive in each of those periods.

Share Repurchase Transactions

On December 15, 2017, the Company's Board of Directors authorized a share repurchase program of up to \$50.0 million of the Company's issued and outstanding common stock from time to time. The timing and size of repurchases will be determined based on market conditions and other factors. The authorization does not obligate the repurchase of any shares and the Company may repurchase shares of common stock at any time without prior notice. The share repurchases will be made in accordance with applicable securities laws in open market or privately negotiated transactions. The authorization does not have a specified expiration date, and the share repurchase program may be suspended, recommenced or discontinued at any time or from time to time without prior notice.

In 2018, the Company repurchased 156,818 shares of its common stock at an average price of \$12.64 per share through market purchases. At December 31, 2020, the Company had \$46.0 million of repurchase authorization available under the December 2017 authorization.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Income Taxes

Income Taxes

The Company uses the asset and liability method to account for income taxes. Under this method, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Any change in tax rates that could impact deferred tax assets or liabilities are recognized in the same period the change occurs. If a net operating loss ("NOL") and/or interest limitation ("163(j)") carryforward exists, the Company makes a determination as to whether that NOL and/or 163(j) carryforward will be utilized in the future. A valuation allowance is established for certain net operating loss and interest limitation carryforwards when their recoverability is deemed to be uncertain. The carrying value of the net deferred tax assets assumes that the Company will be able to generate sufficient future taxable income in certain tax jurisdictions, based on estimates and assumptions. If these estimates and related assumptions change in the future, the Company may be required to adjust its deferred tax valuation allowances.

The Company, or one or more of its subsidiaries, files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years prior to 2017 or state income tax examinations for years prior to 2016.

The Company and certain of its subsidiaries file a consolidated federal income tax return. The partnerships, limited liability companies, and certain non-consolidated physician practice corporations also file separate income tax returns. The Company's allocable portion of each partnership's and limited liability company's income or loss is included in taxable income of the Company. The remaining income or loss of each partnership and limited liability company is allocated to the other owners.

The Company made income tax payments of \$1.7 million, \$1.6 million and \$2.2 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Income tax (benefit) expense is comprised of the following (in millions):

	Year Ended December 31,		
	2020	2019	2018
Current:			
Federal	\$ (0.2)	\$ (0.2)	\$ (0.3)
State	1.9	1.7	1.5
Deferred:			
Federal	(22.2)	3.2	16.5
State	0.4	4.8	8.7
Total income tax (benefit) expense	<u>\$ (20.1)</u>	<u>\$ 9.5</u>	<u>\$ 26.4</u>

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

A reconciliation of the provision for income taxes as reported in the consolidated statements of operations and the amount of income tax (benefit) expense computed by multiplying consolidated income (loss) in each year by the U.S. federal statutory rate of 21% (2020, 2019 and 2018) follows (in millions):

	Year Ended December 31,		
	2020	2019	2018
Tax (benefit) expense at U.S. federal statutory rate	\$ (4.0)	\$ 11.5	\$ (14.5)
State income tax, net of U.S. federal tax benefit	2.4	5.7	10.0
Change in valuation allowance	4.1	13.6	26.9
Net income attributable to non-controlling interests	(24.8)	(25.2)	(23.1)
Changes in measurement of uncertain tax positions	—	(0.1)	(0.1)
Stock option compensation	1.2	1.3	0.5
Differences related to divested facilities	(0.7)	0.1	6.0
Tax return reconciling differences	—	1.1	1.7
Change in effective tax rate	(0.8)	0.3	0.5
Tax Receivable Agreement liability	0.9	1.6	0.9
Goodwill impairment	4.3	0.5	8.9
Litigation settlement	(3.7)	—	8.6
Other	1.0	(0.9)	0.1
Total income tax (benefit) expense	<u>\$ (20.1)</u>	<u>\$ 9.5</u>	<u>\$ 26.4</u>

The components of temporary differences and the approximate tax effects that give rise to the Company's net deferred tax asset are as follows (in millions):

	December 31,	
	2020	2019
Deferred tax assets:		
Medical malpractice liability	\$ 4.0	\$ 3.5
Accrued vacation and incentive compensation	3.2	2.3
Net operating loss carryforwards	164.7	143.0
Allowance for bad debts	2.5	2.2
Capital loss carryforwards	1.7	2.0
Amortization of intangible assets	2.2	0.3
Deferred financing costs	7.9	9.5
Section 163(j) interest	69.8	54.7
Interest rate swap liability	15.8	12.9
TRA liability	1.0	1.2
Right of use	50.6	52.1
Affiliate indebtedness receivable	—	6.8
Other deferred assets	16.4	9.0
Total gross deferred tax assets	<u>339.8</u>	<u>299.5</u>
Less: Valuation allowance	<u>(91.1)</u>	<u>(77.9)</u>
Total deferred tax assets	248.7	221.6
Deferred tax liabilities:		
Depreciation on property and equipment	(1.8)	(2.8)
Basis differences of partnerships and joint ventures	(73.6)	(67.5)
Right of use	(47.5)	(51.5)
Other deferred liabilities	(1.0)	(1.1)
Total deferred tax liabilities	<u>(123.9)</u>	<u>(122.9)</u>
Net deferred tax assets	<u>\$ 124.8</u>	<u>\$ 98.7</u>

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company had federal NOL carryforwards of \$615.7 million as of December 31, 2020, of which \$516.2 million expire between 2026 and 2037. The remaining federal NOL carryforwards, which were generated subsequent to 2017, do not expire. The Company had state NOL carryforwards of \$678.9 million as of December 31, 2020, which expire between 2021 and 2040. The Company had capital loss carryforwards of \$6.2 million as of December 31, 2020, which expire between 2021 and 2023. The Company had federal and state credit carryforwards of \$0.7 million as of December 31, 2020. The federal credits do not expire, and the state credits expire between 2021 and 2031. The Company had IRC Section 163(j) interest limitation carryforwards of \$278.4 million as of December 31, 2020, which do not expire.

The Company has recorded a valuation allowance against deferred tax assets at December 31, 2020 and 2019 totaling \$91.1 million and \$77.9 million, respectively, which represents an increase of \$13.2 million. The valuation allowance continues to be provided for certain deferred tax assets for which the Company believes it is more likely than not that the tax benefits will not be realized, which are primarily Section 163(j) interest carryforwards, certain state NOLs and capital loss carryforwards.

The Company has evaluated the realizability of its deferred tax assets based on sources of positive and negative evidence, and determined that it is more likely than not that the NOL carryforwards will be realized. The determination was made based upon projections of future book and taxable income. If the Company's expectations for future operating results on a consolidated basis or at the state jurisdiction level vary from actual results due to changes in health care regulations, general economic conditions, or other factors, the Company may need to adjust the valuation allowance, for all or a portion of its deferred tax assets. The Company's income tax expense in future periods will be reduced or increased to the extent of offsetting decreases or increases, respectively, in its valuation allowance in the period when the change in circumstances occurs. These changes could have a significant impact on the Company's future earnings.

Included in the increase in the valuation allowance for the year ended December 31, 2020 was an increase of approximately \$2.8 million that was recorded to additional-paid-in-capital as the result of the tax effect of the interest rate swap liability. Approximately \$16.8 million of the valuation allowance as of December 31, 2020 is recorded against deferred tax assets that, if subsequently recognized, will be credited directly to contributed capital.

A reconciliation of the beginning and ending liability for gross unrecognized tax benefits for the years ended December 31, 2020 and 2019 is as follows (in millions):

	December 31,	
	2020	2019
Unrecognized tax benefits at beginning of year	\$ 0.1	\$ 0.1
Reductions for tax positions of prior year	—	—
Unrecognized tax benefits at end of year	\$ 0.1	\$ 0.1

The Company recognizes interest and penalties related to uncertain tax positions in its provision for income taxes in the consolidated statements of operations. For both years ended December 31, 2020 and 2019, the Company had approximately \$0.1 million each of accrued interest and penalties related to uncertain tax positions. The total amount of accrued liabilities related to uncertain tax positions that would affect the Company's effective tax rate, if recognized, is \$0.1 million as of both December 31, 2020 and 2019. The reserves are included in long-term taxes payable in the consolidated balance sheet as of December 31, 2020.

11. Equity-Based Compensation

Transactions in which the Company receives employee and non-employee services in exchange for the Company's equity instruments or liabilities that are based on the fair value of the Company's equity securities or may be settled by the issuance of these securities are accounted for using a fair value method. The Company's policy is to recognize compensation expense using the straight line method over the relevant vesting period for units that vest based on time.

The Surgery Partners, Inc. 2015 Omnibus Incentive Plan, as amended and restated effective January 1, 2020 ("2015 Omnibus Incentive Plan") from which all equity-based awards will be granted. Under this plan, the Company can grant stock options, stock appreciation rights, restricted stock, unrestricted stock, stock units, performance awards, cash awards and other awards convertible into or otherwise based on shares of its common stock. As of December 31, 2020, 8,315,700 shares were authorized to be granted under the 2015 Omnibus Incentive Plan and 5,285,421 were available for future equity grants.

Restricted and Performance Share-Based Awards

During the years ended December 31, 2020 and 2019, the Company granted 1,077,367 and 556,450 restricted stock awards ("RSAs") to certain officers, employees and non-employee directors in accordance with the 2015 Omnibus Incentive Plan, respectively. Vesting and payment of these RSAs are generally subject to continuing service of the employee or non-employee director over the ratable vesting periods beginning one year from the date of grant to three or five years after the date of grant. The fair values of these RSAs were determined based on the closing price of the Company's common stock on the trading date immediately prior to the grant date.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

During the years ended December 31, 2020 and 2019, the Company granted 854,367 and 389,972 performance-based restricted stock units ("PSUs") subject to the achievement of a combination of performance conditions, respectively. In addition to the achievement of the performance conditions, these PSUs are generally subject to the continuing service of the employee over the ratable vesting period from the earned date continuing for two years. For these PSUs, the number of shares payable at the end of the performance periods ranges from 0% to 150% of the targeted units based on the Company's actual performance and/or market conditions results as compared to the targets. These PSUs are not considered outstanding until earned. During the years ended December 31, 2020 and 2019, 309,692 and 245,301 of the PSUs previously granted were deemed to have been earned, respectively.

Restricted and Performance Share-Based Activity

A summary of non-vested restricted share-based activity for the years ended December 31, 2020, 2019, and 2018 follows:

	Unvested Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2017	574,456	\$ 15.95
Granted/Earned	519,605	16.10
Forfeited/Cancelled	(180,719)	15.09
Vested	(210,318)	16.31
Outstanding at December 31, 2018	703,024	\$ 16.18
Granted/Earned	801,751	12.70
Forfeited/Cancelled	(272,706)	12.97
Vested	(456,183)	16.20
Outstanding at December 31, 2019	775,886	\$ 13.78
Granted/Earned	1,387,059	6.87
Forfeited/Cancelled	(162,635)	13.77
Vested	(552,943)	12.78
Outstanding at December 31, 2020	<u>1,447,367</u>	\$ 9.75

Stock Options and Stock Appreciation Rights

The Company granted 2,256,500 and 700,000 stock options during the years ended December 31, 2019 and 2018, respectively. No stock options were granted during the year ended December 31, 2020. Options to purchase shares are granted with an exercise price equal to the fair market value of the Company's common stock on the day of grant, based on the closing price of the Company's common stock on the trading date immediately prior to the grant date.

The stock options granted during the year ended December 31, 2019 are subject to the following performance and vesting criteria: (i) one-third (33.3%) of the award will vest in three equal annual installments on each of the first three anniversaries of December 31, 2019, (ii) one-third (33.3%) of the award will vest based on satisfaction of the time condition and the achievement by the Company of an average closing price of a share of Common Stock on the Nasdaq Stock Market of \$25.00 over a period of thirty (30) consecutive trading days, and (iii) one-third (33.3%) of the award will vest based on satisfaction of the time condition and the achievement by the Company of an average closing price of a share of Common Stock on the Nasdaq Stock Market of \$35.00 over a period of thirty (30) consecutive trading days, in each case, generally subject to continued employment on each vesting date. Forfeitures are recognized as incurred.

The stock options granted during the year ended December 31, 2018 are subject to the following performance and vesting criteria: (i) fifty percent (50%) of the stock option awards will vest in five equal annual installments on each of the first five anniversaries of the date of grant, (ii) twenty-five percent (25%) of the award will vest based on satisfaction of the time condition and the achievement by the Company of an average closing price of a share of Common Stock on the Nasdaq Stock Market of \$25.00 over a period of sixty (60) consecutive trading days, and (iii) twenty-five percent (25%) of the award will vest based on satisfaction of the time condition and the achievement by the Company of an average closing price of a share of Common Stock on the Nasdaq Stock Market of \$35.00 over a period of sixty (60) consecutive trading days, in each case, generally subject to continued employment on each vesting date. Forfeitures are recognized as incurred.

On December 16, 2018, the Company cancelled 200,000 stock options and replaced them with 200,000 stock-settled stock appreciation right awards (the "SAR Awards"). These were the only SAR Awards granted as of December 31, 2020. The SAR Awards had a base price equal to the exercise price of the cancelled stock options. Fifty percent (50%) of the SAR Awards will vest in five equal annual installments on each of the first five anniversaries of the date of grant, generally subject to continued employment on each vesting date. Twenty-five percent (25%) of the award will vest based on satisfaction of the time condition and the achievement by the Company of an average closing price of a share of Common Stock on the Nasdaq Stock Market of \$25.00 over a period of sixty (60) consecutive trading days, and twenty-five percent (25%) of the award will vest based on satisfaction of the time condition and the achievement by the Company of an average closing price of a share of Common Stock on the Nasdaq Stock Market of \$35.00 over a period of sixty (60) consecutive trading days, in each case, generally subject to continued employment on each vesting date. Forfeitures are recognized as incurred.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Option/SAR Valuation

In applying the Monte Carlo simulation model to value both the stock options and SAR Awards, the Company used the following assumptions:

- *Risk-free interest rate.* The risk-free interest rate is used as a component of the fair value of stock options to take into account the time value of money. For the risk-free interest rate, the Company uses the implied yield on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life, in years, of the options granted.
- *Expected volatility.* Volatility, for the purpose of share-based compensation, is a measurement of the amount that a share price has fluctuated. Expected volatility involves reviewing historical volatility and determining what, if any, change the share price will have in the future. The Company used historical stock price information of certain peer group companies for a period of time equal to the expected option life period to determine estimated volatility.
- *Expected life, in years.* A clear distinction is made between the expected life of an option and the contractual term of the option. The expected life of an option is considered the amount of time, in years, that an option is expected to be outstanding before it is exercised. Whereas, the contractual term of the stock option is the term an option is valid before it expires.
- *Expected dividend yield.* Since issuing dividends will affect the fair value of a stock option, GAAP requires companies to estimate future dividend yields or payments. The Company has not historically issued dividends and does not intend to issue dividends in the future. As a result, the Company does not apply a dividend yield component to its valuation.

The following table sets forth the assumptions used by the Company to estimate the fair value of stock options and SAR Awards granted during the years ended December 31, 2019 and 2018. No stock options or SAR Awards were granted during the year ended December 31, 2020.

	<u>2019</u>	<u>2018</u>
Expected volatility	60 %	60% - 65%
Risk-free interest rate	2.30% - 2.40%	2.50% - 2.90%
Expected dividends	—	—
Average expected term (years)	4	10
Fair value of stock options granted	\$4.83 - \$6.41	\$8.48 - \$9.44

The estimated fair value of options is amortized to expense on a straight-line basis over the options' vesting period.

Stock Option and Stock Appreciation Rights Activity

A summary of stock option and SAR Award activity for the years ended December 31, 2020, 2019, and 2018 follows:

	<u>Options/ SARs</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (years)</u>
Outstanding at December 31, 2017	12,687	\$ 20.10	1.2
Granted	700,000	12.90	10.0
Exercised	—		
Forfeited/Cancelled	(200,000)	12.90	10.0
Outstanding at December 31, 2018	512,687	\$ 13.03	9.8
Granted	2,256,500	13.00	9.2
Exercised	—		
Forfeited/Cancelled	—		
Outstanding at December 31, 2019	2,769,187	\$ 13.02	9.0
Granted	—		
Exercised	(4,199)	20.24	5.8
Forfeited/Cancelled	(4,473)	19.00	4.8
Outstanding at December 31, 2020 ⁽¹⁾	<u>2,760,515</u>	\$ 12.88	8.0

⁽¹⁾ Of the outstanding stock options, 585,119 were exercisable as of December 31, 2020.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Other information pertaining to equity-based compensation

At December 31, 2020, unrecognized compensation cost related to unvested shares was approximately \$20.2 million. Unrecognized compensation cost will be expensed annually based on the number of shares that vest during the year.

The Company records equity-based compensation expense to recognize the fair value of the restricted shares that vest and stock options granted. The Company recorded equity-based compensation expense of \$13.2 million, \$10.2 million and \$9.3 million for the years ended December 31, 2020, 2019, and 2018, respectively.

12. Employee Benefit Plans

Surgery Partners 401(k) Plan

The Surgery Partners 401(k) Plan is a defined contribution plan whereby certain employees who have completed at least one month of service, including at least one hour of service during that period of time, are eligible to participate. Employees may enroll in the plan immediately upon completion of the minimum service requirement. The Surgery Partners 401(k) Plan allows eligible employees to make contributions of varying percentages or flat dollar amounts of their annual compensation, up to the maximum allowable amounts by the Internal Revenue Service ("IRS"). Eligible employees may or may not receive a match by the Company of their contributions. Employer contributions vest incrementally over a period of five years. The Company's contributions were \$7.2 million for the year ended December 31, 2020 and \$7.6 million for each of the years ended December 31, 2019 and 2018.

13. Other Current Liabilities

A summary of other current liabilities is as follows (in millions):

	December 31,	
	2020	2019
Right-of-use operating lease liabilities	\$ 39.2	\$ 37.3
Accrued legal settlement ⁽¹⁾	32.2	35.1
Interest payable	24.5	21.8
Tax receivable agreement liability	21.2	16.9
Amounts due to patients and payors	20.9	16.5
Cost report liabilities	16.9	5.6
Accrued expenses and other	62.1	58.0
Total	<u>\$ 217.0</u>	<u>\$ 191.2</u>

(1) See Note 14. "Commitments and Contingencies" for further discussion.

14. Commitments and Contingencies

Professional, General and Workers' Compensation Liability Risks

The Company is subject to claims and legal actions in the ordinary course of business, including claims relating to patient treatment, employment practices and personal injuries. The Company maintains professional, general and workers' compensation liability insurance in excess of self-insured retentions, through third party commercial insurance carriers. Although management believes the coverage is sufficient for the Company's operations, some claims may potentially exceed the scope of coverage in effect. Plaintiffs in these matters may request punitive or other damages that may not be covered by insurance. The Company is not aware of any such proceedings that are reasonably possible to have a material adverse effect on the Company's business, financial position, results of operations or liquidity. Total professional, general and workers' compensation claim liabilities as of December 31, 2020 and 2019 were \$21.4 million and \$19.4 million, respectively. Expected insurance recoveries of \$10.5 million and \$12.1 million as of December 31, 2020 and 2019, respectively, are included as a component of other current assets and other long-term assets in the consolidated balance sheets.

Laws and Regulations

Laws and regulations governing the Company's business, including those relating to the Medicare and Medicaid programs, are complex and subject to interpretation. These laws and regulations govern every aspect of how the Company's surgical facilities conduct their operations, from licensing requirements to how and whether the Company's facilities may receive payments pursuant to the Medicare and Medicaid programs. Compliance with such laws and regulations can be subject to future government agency review and interpretation as well as legislative changes to such laws. Noncompliance with such laws and regulations may subject the Company to significant regulatory sanctions including fines, penalties, and exclusion from the Medicare, Medicaid and other federal health care programs. From time to time, governmental regulatory agencies will conduct inquiries of the Company's practices, including, but not limited to, the Company's compliance with federal and state fraud and abuse laws, billing practices and relationships with physicians.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Government Settlement

On April 14, 2020, Logan Laboratories, LLC ("Logan Labs"), a toxicology laboratory based in Tampa, Florida, that provides urine testing services and Tampa Pain Relief Centers, Inc. ("Tampa Pain" and, together with Logan Labs, the "Companies"), a pain management medical practice based in Tampa, Florida, both indirect wholly-owned subsidiaries of the Company, entered into a settlement agreement (the "Settlement Agreement") with the United States of America, acting through the United States Department of Justice ("DOJ") and on behalf of the Office of Inspector General of the Department of Health and Human Services ("OIG"), the Defense Health Agency, acting on behalf of the TRICARE Program, the Office of Personnel Management, as the administrator of the Federal Employees Health Benefits Program, the Office of Workers Compensation Programs of the United States Department of Labor, which administers federal workers compensation claims for federal employees, including the United States Postal Service, and the United States Department of Veterans Affairs (collectively, the "U.S. Parties") and certain other parties to resolve the pending DOJ investigation.

Under the terms of the Settlement Agreement, the Companies still owe payment of \$30.7 million plus accrued interest on April 1, 2021. The Company previously recorded a litigation-related charge of \$46.0 million relating to an anticipated resolution of the DOJ investigation on the consolidated statements of operations for the year ended December 31, 2018. For the year ended December 31, 2020, the Company recorded an additional litigation-related charge of \$1.2 million relating to the resolution of the Covered Conduct on the consolidated statement of operations.

Acquired Facilities

The Company, through its wholly-owned subsidiaries or controlled partnerships and limited liability companies, has acquired and will continue to acquire surgical facilities with prior operating histories. Such facilities may have unknown or contingent liabilities, including liabilities for failure to comply with health care laws and regulations, such as billing and reimbursement laws and regulations, the Stark Law, the Anti-Kickback Statute, the FCA, and similar fraud and abuse laws. Although the Company attempts to assure that no such liabilities exist, obtain indemnification from prospective sellers covering such matters and institute policies designed to conform centers to its standards following completion of acquisitions, there can be no assurance that the Company will not become liable for past activities that may later be asserted to be improper by private plaintiffs or government agencies. There can be no assurance that any such matter will be covered by indemnification or, if covered, that the liability sustained will not exceed contractual limits or the financial capacity of the indemnifying party.

The Company cannot predict whether federal or state statutory or regulatory provisions will be enacted that would prohibit or otherwise regulate relationships which the Company has established or may establish with other health care providers or have materially adverse effects on its business or revenues arising from such future actions. Management believes, however, that it will be able to adjust the Company's operations so as to be in compliance with any statutory or regulatory provision as may be applicable.

Potential Physician Investor Liability

A majority of the physician investors in the partnerships and limited liability companies which operate the Company's surgical facilities carry general and professional liability insurance on a claims-made basis. Each partnership or limited liability company may, however, be liable for damages to persons or property arising from occurrences at the surgical facilities. Although the various physician investors and other surgeons generally are required to obtain general and professional liability insurance with tail coverage that extends beyond the period of any claims-made policies, such individuals may not be able to obtain coverage in amounts sufficient to cover all potential liability. Since most insurance policies contain exclusions, the physician investors will not be insured against all possible occurrences. In the event of an uninsured or underinsured loss, the value of an investment in the partnership interests or limited liability company membership units and the amount of distributions could be adversely affected.

Tax Receivable Agreement

On May 9, 2017, the Company entered into an agreement to amend that certain Income Tax Receivable Agreement, dated September 30, 2015 (as amended, the "TRA"), by and between the Company, and the other parties referred to therein, which amendment became effective on August 31, 2017. Pursuant to the amendment to the TRA, the Company agreed to make payments to H.I.G., the Company's former controlling shareholder, in its capacity as the stockholders representative pursuant to a fixed payment schedule. The amounts payable under the TRA are calculated as the product of (i) an annual base amount and (ii) the maximum corporate federal income tax rate for the applicable year plus three percent. The amounts payable under the TRA are related to the Company's projected realized tax savings over the next five years and are not dependent on the Company's actual tax savings over such period. The calculation of amounts payable pursuant to the TRA is thus dependent on the maximum corporate federal income tax rate. To the extent that the Company is unable to make payments under the TRA, such payments will be deferred and will accrue interest at a rate of LIBOR plus 500 basis points until paid. If the terms of credit agreements and other debt documents cause the Company to be unable to make payments under the TRA and such terms are not materially more restrictive than those existing as of September 30, 2015, such payments will be deferred and will accrue interest at a rate of LIBOR plus 300 basis points until paid.

Assuming the Company's tax rate is 24%, calculated as the maximum corporate federal tax rate plus three percent, throughout the remaining term of the TRA, the Company estimates the total remaining amounts payable under the TRA was approximately \$43.2 million and \$60.1 million as of December 31, 2020 and 2019, respectively. The carrying value of the liability under the TRA, reflecting a discount, was \$37.0 million and \$48.7 million as of December 31, 2020 and 2019, respectively. The current portion of the liability was \$21.2 million and \$16.9 million as of December 31, 2020 and 2019, respectively, and is included as a component of other current liabilities in the

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

consolidated balance sheets. The long-term portion is included as a component of other long-term liabilities in the consolidated balance sheets.

15. Segment Reporting

The Company operates in three major lines of business that are also the Company's reportable operating segments - the operation of surgical facilities, the operation of ancillary services and the operation of optical services. The Surgical Facility Services segment consists of the operation of ASCs and surgical hospitals and includes anesthesia services. The Ancillary Services segment consists of multi-specialty physician practices and a diagnostic laboratory, which was closed during the third quarter of 2020. The Optical Services segment consists of an optical products group purchasing organization, which was sold on December 31, 2020, as discussed in Note 2. "Acquisitions and Disposals." "All other" primarily consists of the Company's corporate general and administrative functions.

The following tables present financial information for each reportable segment (in millions):

	Year Ended December 31,		
	2020	2019	2018
Revenues:			
Surgical Facility Services	\$ 1,793.4	\$ 1,748.2	\$ 1,682.4
Ancillary Services	63.6	79.4	79.6
Optical Services	3.1	3.8	9.5
Total	<u>\$ 1,860.1</u>	<u>\$ 1,831.4</u>	<u>\$ 1,771.5</u>
Adjusted EBITDA:			
Surgical Facility Services	\$ 339.3	\$ 328.9	\$ 309.5
Ancillary Services	(3.4)	2.6	3.0
Optical Services	1.4	1.4	2.5
All other	(80.7)	(74.3)	(80.2)
Total	<u>\$ 256.6</u>	<u>\$ 258.6</u>	<u>\$ 234.8</u>
Reconciliation of Adjusted EBITDA:			
(Loss) income before income taxes	\$ (18.8)	\$ 54.6	\$ (69.2)
Net income attributable to non-controlling interests	(117.4)	(119.9)	(110.1)
Depreciation and amortization	94.8	76.5	67.4
Interest expense, net	201.8	178.9	147.0
Equity-based compensation expense	13.2	10.2	9.3
Transaction, integration and acquisition costs ⁽¹⁾	38.2	36.1	34.0
Impairment charges	33.5	7.9	74.4
Loss (gain) on disposals and deconsolidations, net	5.7	(4.4)	31.8
Litigation settlement and other litigation costs ⁽²⁾	6.4	4.6	46.0
Reserve adjustments ⁽³⁾	—	—	2.7
Contingent acquisition compensation expense	—	—	1.5
Gain on escrow release ⁽⁴⁾	(0.8)	—	—
Loss on debt extinguishment	—	11.7	—
Tax receivable agreement expense	—	2.4	—
Adjusted EBITDA	<u>\$ 256.6</u>	<u>\$ 258.6</u>	<u>\$ 234.8</u>

(1) For the year ended December 31, 2020, this amount includes transaction and integration costs of \$23.2 million, of which \$6.6 million were acquisition related costs, and includes start-up costs related to a de novo surgical hospital of \$15.0 million. For the year ended December 31, 2019, this amount includes transaction and integration costs of \$19.0 million, and includes other acquisition costs and start-up costs related to a de novo surgical hospital of \$17.1 million. For the year ended December 31, 2018, this amount includes transaction and integration costs of \$31.7 million, and includes other acquisition costs of \$2.3 million.

SURGERY PARTNERS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

- (2) This amount includes litigation settlement costs of \$1.2 million, \$0.2 million and \$46.0 million for the years ended December 31, 2020, 2019 and 2018, respectively. This amount further includes other litigation costs of \$5.2 million and \$4.4 million for the years ended December 31, 2020 and 2019, respectively, with no comparable costs in 2018.
- (3) This amount represents adjustments to revenue in order to apply consistent policies to businesses acquired by Surgery Partners in prior periods.
- (4) Included in other income in the consolidated statement of operations for the year ended December 31, 2020, with no comparable gain in 2019 and 2018.

	December 31,	
	2020	2019
Assets:		
Surgical Facility Services	\$ 4,962.4	\$ 4,580.4
Ancillary Services	35.0	69.6
Optical Services	—	17.7
All other	415.8	351.2
Total assets	<u>\$ 5,413.2</u>	<u>\$ 5,018.9</u>

	Year Ended December 31,		
	2020	2019	2018
Cash purchases of property and equipment:			
Surgical Facility Services	\$ 38.7	\$ 65.9	\$ 34.2
Ancillary Services	0.4	1.1	0.4
All other	3.8	6.6	5.2
Total cash purchases of property and equipment	<u>\$ 42.9</u>	<u>\$ 73.6</u>	<u>\$ 39.8</u>

16. Subsequent Events

On January 27, 2021, the Company entered into an underwriting agreement relating to a public offering of 7,500,000 shares (the “Firm Shares”) of the Company’s common stock, \$0.01 par value per share, at a price to the public of \$30.25 per share. In addition, the Company granted the underwriters an option to purchase up to an additional 1,125,000 shares of common stock at the same price per share as the Firm Shares. On February 1, 2021, the Company completed the public offering pursuant to which the Company sold 8,625,000 shares of common stock, resulting in net proceeds of \$249.2 million, net of underwriting discounts and commissions.

On January 27, 2021, the Company entered into an amendment to the credit agreement governing the Revolver, dated as of January 27, 2021 (the “Amendment”), which amended and supplemented the credit agreement, dated as of August 31, 2017, to provide for an extension of the maturity date of the Revolver to February 1, 2026 and an increase in the outstanding commitments under the Revolver in an amount equal to \$50.0 million. The maturity extension and the additional commitments became operative on February 1, 2021, upon satisfaction by the Borrower of certain conditions precedent set forth in the Amendment, including the closing of the offering of the Firm Shares.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SURGERY PARTNERS, INC.

By: /s/ J. Eric Evans
J. Eric Evans
Chief Executive Officer
(Principal Executive Officer)

Date: March 10, 2021

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURES	TITLE	DATE
<u>/s/ J. Eric Evans</u> J. Eric Evans	Chief Executive Officer, Director (Principal Executive Officer)	March 10, 2021
<u>/s/ Thomas F. Cowhey</u> Thomas F. Cowhey	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 10, 2021
<u>/s/ Wayne S. DeVeydt</u> Wayne S. DeVeydt	Executive Chairman of the Board	March 10, 2021
<u>/s/ T. Devin O'Reilly</u> T. Devin O'Reilly	Director	March 10, 2021
<u>/s/ Teresa DeLuca</u> Teresa DeLuca	Director	March 10, 2021
<u>/s/ John A. Deane</u> John A. Deane	Director	March 10, 2021
<u>/s/ Brent Turner</u> Brent Turner	Director	March 10, 2021
<u>/s/ Andrew Kaplan</u> Andrew Kaplan	Director	March 10, 2021
<u>/s/ Clifford G. Adlerz</u> Clifford G. Adlerz	Director	March 10, 2021