EDUCATION by SCALE healthcare

CEO Leadership Series: Vol. 1

REVELSTOKE CAPITAL PARTNERS

A Sponsor Perspective on MSO Transactions with Physician Platforms

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The **SCALE Interview Series with Physician Platform Industry Leaders**, Roy Bejarano, SCALE Healthcare's Co-Founder and CEO, sat down with Andrew Welch, Managing Director at Revelstoke Capital Partners LLC, to get his perspective on the ways in which private equity groups can successfully navigate and execute an MSO transaction with a physician group.

Revelstoke is a Denver, Colorado based Private Equity firm formed by experienced investors with a focus on healthcare services.

Outside of meeting minimum EBITDA requirements and target specialty, what attributes do you look for in a target physician group? What non-financial / non-specialty characteristics would make you more likely to pass on an opportunity?

We look at several factors, including:

1. Whether the opportunity should be classified as a new platform (>$10MM EBITDA) versus an add-on (lower EBITDA is fine).
2. A culture of quality and compliance, demonstrated by several indicators:
    - Peer physician references
    - Patient satisfaction reviews (this is becoming increasingly important and ever more accessible in today's social media landscape)
    - Other ancillary metrics, such as clinical metrics that convey quality, malpractice history and billing / coding / compliance audits from third parties
3. The scale of the operations, ancillary services, and quality of management team; every practice is using the word "platform" regardless of whether they have achieved it – the question is whether they're ready to double or triple in size
4. The number of doctors; more than 10 physician partners / providers is critical to prevent provider concentration. There are employee models in dermatology and dental practices, and in many ways, these are much easier businesses to scale. In fact, the partner tracks are harder to manage – owners need to recognize the value of non- owner providers. We are coaching providers to set aside generous pools to share with non-owners (bonus pools) who are on the shareholder track. We set up equity plans for recruiting future physicians but feel that it's the responsibility of the shareholders to take care of existing shareholder-track providers. As important as economics is communication with shareholder-track physicians; treat them as if they were a junior partner include them in strategic discussions.

What are some of the common reasons why physician platform deals fail between LOI execution and close? What could parties do to help mitigate these risks?

Typically deals fail for financial reasons – the numbers don't stick – cash vs. accrual – pro-forma changes in compensation. We recommend practices evaluating these types of transactions get a sell-side Q of E done early before the buyers show up to ground shareholders expectations and avoid presenting an inflated/ unrealistic EBITDA. Strong lawyers and accountants are essential to close a deal, but early involvement by an experienced and prudent investment banker can help keep the process on track as well. The finer details of a transaction need to be accurately and appropriately communicated to shareholder physicians.

Another reason deals can fail is a lack of physician management consensus behind the transaction. Establishing a clear champion and supportive coalition takes a lot of time. Multiple meetings with physician leadership – and at least two in person meetings with the entire physician group and the sponsor – are essential. Everyone needs to look everyone in the eye. It's very important for all the physicians to hear directly from the sponsor. You don't want a physician member to say he has never met with the sponsor.

Remember, physicians can be your single greatest ally or obstacle – the priority should be to include them as much as possible.

As an investor, you need to bring your physician leaders to all initial meetings with tuck-in platforms – they are your best advocate.

A lot of physicians are interested in private equity transaction, but express concerns about key recurring topics (outlined below). What feedback would you offer the following common concerns?

Common Concern 1: What will be my opportunity to realize my MSO equity rollover value when the private equity firm sells in 3-5 years?

There has to be future liquidity for the doctors, and it can be comparable to the initial liquidity event if the business grows / performs. Subsequent investors will want to see some continued skin in the game though so they should expect some amount of rollover in future transactions as well.

Common Concern 2: The business plan being put forth is ambitious – how will a private equity firm with limited healthcare operation expertise give us confidence that the projected results are realistic and will be realized?

Critical that management team and physicians and sponsor all buy into the plan – we have strategy sessions before the deal closes to make sure there is alignment on a detailed, actionable, achievable growth plan and the economics for all parties are compelling.

Common Concern 3: What representation do physicians have in on-going governance? How do we avoid feeling like we are working for a corporation vs. a medical practice?

Governance is complicated, and there is an important distinction between representation and governance; we try to maintain or increase representation by physicians – keep them actively engaged – while providing the appropriate governance for a control investor. In most cases, 99% of what gets discussed in a board meeting never goes to a vote – in this light, the sponsors

should remain focused on the few critical voting decisions that arise, e.g. liquidity events. At the end of the day, without physician support you have very little control – partnership should come before governance.

What are the top challenges you underestimated or didn't expect in scaling physician platforms across geographies? What strategies did you turn to in order to help navigate those situations?

Accounting and Finance are areas that always need more resources – it's uncommon for these businesses to be on an accrual basis – transitioning from private to institutional ownership level of reporting is much greater, very different, and if you couple that with the volume of acquisitions, finance and accounting can become a limiting constraint to growth. 100% of the time, there is need for financial resources and it's hard to factor that into up-front valuations, but we model for it in terms of the business plan and impact on returns.

What are the top 1-2 opportunities you underestimated or didn't expect in scaling physician platform across geographies?

The inbound interest from other practices has been significant – it allows us to be very picky in choosing who to partner with. There is a ton of opportunity across the board. I am a true believer in the platform concept – it is more difficult start to finish vs. a services business – but if you find the right partners and the right management team, and the right support from true experts, it's a great model. We can't wait to partner with SPG to help solve these challenges.

Special thanks to Andrew Welch for his insights and our Executive for their participation in this discussion.