EDUCATION by SCALE healthcare

CEO Leadership Series: Vol. 2

William Blair

An Investment Banker's Insights on Physician Platform M&A

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Roy Bejarano, **SCALE Healthcare's** Co-Founder and CEO, recently had the opportunity to speak with Fritz Buerger, Managing Director at **William Blair & Company,** about scaling transaction execution from the perspective of an M&A advisor.

William Blair is a premier global boutique with expertise in investment banking, investment management, and private wealth management. Fritz has worked in the healthcare space for more than 10 years.

How long is the average physician platform deal process from start to finish? What are the key phases and typical timelines for each phase?

The time spent preparing for a deal process can vary significantly because it is influenced by several factors. Typically, our clients have an exciting growth story they want to share, so we want to make sure that story is easy for potential buyers to understand and analyze through their due diligence. That means we spend a lot of time on clinic expansion—including efforts to advance target acquisitions to the letter of intent (LOI) stage or develop the de novo playbook for opening new locations—and the quality of earnings (particularly when we need to transition from cash-based to accrual accounting).

The reason it takes so long is because it is crucial to get these right. For example, on the quality of earnings, extracting the right data and creating the right context isn't easy, even with the best accounting firms. For acquisitions, physicians can underestimate the time involved in getting a deal done, especially when they are just beginning to pursue an M&A strategy. It is better to take time getting to an LOI because you don't want a surprise during your sale process.

Overall, I've seen physician groups and their advisors get ready in as quick as 90 days, and for some, it can take up to a year.

How does your team handle a year of preparatory work?

We don't plan for a year of preparation but if it happens, we're working right alongside our client to make sure everything is progressing as efficiently as possible.

Additionally, it is extremely valuable to have external advisors who can partner with physician groups to identify any holes in their platform or operations that may distract from key growth initiatives. For example, can your COO take the time to do M&A if he/she is busy working on internal issues? The owners need to understand that real growth requires significant internal resources and a shift in how you do things before that growth takes place. Many businesses struggle with this shift in thinking. The inclination is to defend the status quo and your people, rather than embracing the change that is required.

What are the usual reasons why a process deviates from the average timeline—either a faster than average or materially delayed process? What are reasons a deal might not get completed?

Delays can happen for numerous reasons. As I mentioned earlier, getting the financials right or building an M&A pipeline can take time, are critical to the success of the deal, and often are out of our control.

As it relates to completing a deal, establishing expectations ahead of a process is crucial. All of the parties involved in a transaction (physicians, investors, bankers, etc.) come in with expectations based on information that isn't always accurate or complete.

> I encourage physicians and managers to focus on how they can get their practice to a better place than it would be on its own. That will be a different answer for everyone, but it usually means focusing on goals measured in terms of years and not weeks.

The physician groups that can most effectively communicate those goals and what they have done to position themselves to accomplish them are the deals that go fastest. The organizations that struggle to understand what they want from a partner (beyond money) are the ones that typically suffer delays because it is tough to invent a growth strategy.

Those expectations continually evolve as sellers and buyers learn more. For example, what adjustments are standard vs. what is typically considered part of a "growth multiple"? What is a reasonable expectation for growth rates? That is where an advisor who has completed many deals can really add value. Advisors who can set the right expectations—for both sides of a transaction—typically get more transactions done.

Many bankers represent a very high closure rate on deals. How is a statistic like that verified?

It is very tough to verify closure rates because you are typically relying on self-reported data (M&A isn't as rigorous as a clinical trial). Another reason it is difficult to verify is because the definition of "closure rate" is open to interpretation. I will give you a few examples. Someone hires a banker, goes to market, and doesn't get a deal done. However, they wait a year, the business grows considerably, and eventually is sold at a much higher multiple. Is that a success because they got a higher price or a failure because it took twice as long as expected? Or the inverse; a business is approached by an investor and hires a banker for a short window of negotiations. If the banker ultimately recommends against accepting a below-market offer, is that a failure because a deal didn't get completed or a success because the banker gave his/her client feedback intending to create more long-term value?

The bottom line is that there are better ways of selecting an advisor than relying on a metric like closure rate. Focus on their relationships (with other executives, with other clients, with their fellow partners, etc.) and the level of trust you have in them. You need to look deeper to find who's best positioned to represent your interests.

That brings up an interesting angle—a lot of sellers may be interested in "shopping" but may not necessarily be well-positioned to close. If you were to make a rubric for evaluating the likelihood of closing, what would you focus on?

From the perspective of a buyer evaluating a seller, I would focus on the quality of advice the seller's owners are getting and who they are surrounding themselves with (which bankers, lawyers, accountants, etc.). Have they expended considerable thought and effort into why they are pursuing a deal now? If sellers are using out-of-market positions on EBITDA, forecasting transformational growth, etc., then it is likely good to probe on value early to ensure expectations aren't unreasonable. Lastly, I'd probe to see if they understand the full extent of what diligence needs to get completed. Many physician owners aren't aware of the level of diligence an investor requires to complete a deal, and it can be an emotionally draining process to get through when they don't understand all the steps in advance.

I see a lot of physician owners sign an LOI and think that their job is done. How would you advise them to continue to evaluate the odds of a closure?

You're right that an LOI and a dinner doesn't mean you are closing in a month. I've found the odds of closing are correlated with the amount of resources the buyer has invested into the deal. Many investors consider time to be their most valuable asset, so if they are spending considerable time with you, that is a good sign.

Also, consider who from the fund is working with you. Ideally, you're negotiating with someone who has credibility and influence with the fund's investment committee, as that is usually the ultimate authority on whether they will make an investment.

What do you think is the average timeline between a signed LOI and a platform MSO closing?

It depends on how much work has been completed before the LOI is signed. If a physician group has been working with a qualified banker, then hopefully the process between signing and closing is relatively efficient, maybe as little as 30-45 days.

However, things like physician retirements, different sensitivities to income repair among younger and older physicians, transitioning or consolidating MSO services, transfer of staff employment agreements—these are all things that can take much longer than 30 days to properly address. Sometimes it can be several months.

Not all LOIs are comparable. What are some criteria sellers should be aware of when comparing offers in terms of [1] up-front consideration and [2] post-close upside? How do you advise physicians to look much deeper than who is offering the highest EBITDA multiple?

This goes back to setting expectations and understanding your goals for the next 5-10 years or more. For some clients, a transaction is a transition to another stage of life or career, and the cash at close matters more to them. For others, they want the resources, support, and energy that a new partner brings. If your advisor doesn't understand your goals, your advisor can't advocate most effectively for you.

In terms of criteria to consider for the post-close upside, I've had a range of experiences with clients. Some were supremely confident in their potential and valued their equity at levels above where the buyer did. Others put all post-close contingency payments at zero. My advice is to design post-closing structures that are mutually beneficial and based on growth rates similar to your historical performance. Zero-sum arrangements often create stress between partners, and upside plans dependent on dramatic swings in growth are difficult to achieve.

If a physician wants to look deeper than just price, having an advisor who knows the industry and has deep relationships can really help. An advisor who has deep experience working with physician groups can give valuable feedback and help you network to do your reference checks on the sponsor.

What are the key features of a platform that is ready to go to market as a founding platform? What advice do you have for a platform that may be missing some of these features as they think through whether or not to go to market now?

Growth is the word that comes to mind, and it can be expressed in a number of different ways.

One element is being able to outperform the market with organic (or same store) growth. To me, that means the management/physician team is doing something better than their peers. Another element is having invested in infrastructure and capacity to enable more M&A or de novo locations. A final piece is bringing on more executives. Many physician groups underestimate the size of the team needed to accomplish everything in their growth plan. Hiring more talent and surrounding yourself with great executives is rarely a bad strategy.

If you haven't been treating your business like a platform already, it is difficult to make that change during a transaction process. If you think you want a sponsor partner at any point, you need to start investing now in bringing in the management support needed to execute your growth strategy and identifying outside advisors. Outside expertise is critical.

When is it appropriate for a group to think of themselves as an add-on transaction vs. a founding platform? What are some terms that an add-on platform can ask for to preserve upside and autonomy in the context of an add-on deal?

I'm seeing lower thresholds for what constitutes a "platform." To me, it isn't about size as much as the ability and readiness to grow. There is a mental element to being a platform—you have to be very open to ongoing change and ready to accept support and perspectives from a variety of new angles. For example, consumerism is quickly embedding itself in healthcare, but I don't see many physicians reaching out to speak with former retail executives or managers to run their practices.

I think the term "add on" gets used in a much more pejorative manner than it should. Many practices are better suited to joining a larger group. Doing some honest self-reflection and trying to eliminate ego from that decision is necessary but tough. You can get great pricing as an add-on and actually end up with a far better work/life balance than trying to be the platform.

Some transactions are completed without a banker. And some sellers feel like as long as they have any banker, they are in good shape. How do you specifically add value as it relates to:

- **Sourcing the most favorable terms?**
- **Increasing probability of closing?**
- **Executing in line with budget timeline and cost?**

At William Blair, we feel that we have exceptional talent, relationships, and knowledge that we bring to every client relationship. Like many physician groups, our partnership structure allows us to recruit and retain the best. I've been here more than 15 years and have been awed at how much bigger, better, and more advanced we get every year. We are No. 1 in sponsor-related deals under $2 billion, so we have incredible relationships throughout private equity. The best part is that I feel like we have just scratched the surface of what our potential can be.

As a result, we have been fortunate to be affiliated with best-in-class organizations.

> We want to work with individuals and organizations that are changing the world for the better as that allows us to build on our industry-leading reputation.

To directly answer your question, I have done about 40 platform deals. Across those transactions, I have seen every iteration of what a physician group can be—government/commercial/self-pay, M&A/de novo growth, branded/non-branded, direct-to-consumer/referral driven, etc. I have also completed transactions across a variety of sectors—veterinary, eye care, dental, dermatology, urgent care, physical therapy, behavioral, etc. This experience allows me to understand how sectors compare favorably and unfavorably. I enjoy bringing this knowledge and experience to any situation where I can help a physician group.

One of the challenges we commonly see in physician platform deals is communication. Each seller brings his/her own perspective, questions, and concerns. What are some strategies that you have used to successfully manage this dynamic and bridge communication gaps between the buyer, the board, and the seller's broader physician membership?

I wish I had a fail-proof strategy, but the challenge is that this is unique to each group. If you are a seller, the best advice I can give is be open and transparent with the full physician members about your goals early on. Obtain agreement and buy-in from all levels (senior partners, mid-careers, new graduates, executives, clinical staff, etc.) for why a transaction makes sense beyond the immediate financial upside.

> If you can garner support early for the ideas of growth, organizational transformation, and addressing long-term strategic priorities, then communication gaps are less likely to open up later.

This involves a lot of direct conversation and can be difficult to do. But this question reminds me of a quote I like: "The level of communication needed is inversely proportional to the level of trust. If I trust you completely, then I require no explanation, because I know you are working to further my interests. If I don't trust you, then no amount of communication will have any effect on me."

Think about how much trust you have in your fellow partners and how much they trust you. That will tell you how much communication you will need throughout the process.

As a buyer, think about how you establish that trust early. Share about yourself personally and professionally. The more you can build trust, the more likely it will be that you will get access to the broader physician membership and can build broad consensus for why you are the best partner possible.

One of the things I recommend is an interim full membership vote on not just the LOI, but even the latest and greatest deal terms that typically go far beyond an LOI, including retirement language, draft purchase agreement, etc. I like to see votes of confidence along the way. Have you experienced a similar strategy?

Yes. These votes go a long way toward making sure everyone has bought in. If you are a practice that doesn't communicate much, I would encourage a regular call inviting all physicians to dial in as these turn deal spectators into participants. It is a great way to determine if the group's goals have changed or if the transaction is meeting your expectations.

Any last thoughts?

Like you, I share a passion for helping physicians. I love pairing them with the sponsors that want to do right by their doctors, the management teams, and above all, the patients. There are great sponsors out there, and they are truly wonderful to work with.

Special thanks to Fritz Buerger for his insights and our Executive for their participation in this discussion.

EDUCATION by SCALE healthcare

SCALE prides itself in developing customized solutions for its clients and helping physician groups grow and thrive in a challenging marketplace. Now, we are ready to help you. We look forward to sharing examples of how we have helped our clients and invite you to schedule a 1-on-1 complimentary consultation with us.

Contact Kevin Gillis at kgillis@scale-healthcare.com, or +1 (603) 440-3375 to continue the conversation.