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A DEEP DIVE INTO MEDICAL PRACTICE M&A WITH CLINT BUNDY & MATT EBBEL (PART 2)

David Mandell:

Matt, coming back to you and then we'll go back to Clint. When you look at a potential medical practice or dental practice, and I know given on what you said before, oftentimes you're not doing it directly, you're doing it through a platform, but ultimately they're probably not doing unless you take a look at it because you're the capital partner. So what are some success factors you want to see and what are some red flags that give you pause if you're saying if you're talking to the platform about a potential acquisition and you're putting your two sets in?

Matt Ebbel:

Yeah, thanks. Look, the way I think about it it's for physicians, it's about the day after, and the day after you have got a check in the bank account, you likely have equity rolled over into this new platform so you have a smaller piece of the bigger pie, and you have a boss and you probably haven't had a boss in a long time. So what does that look like and what does that relationship, we have studied each of our companies, which acquisitions have gone well and which haven't, and anyone who's done enough of them has stories on both sides of that equation. And you look for cues and over time you just more and more try and get to the point of, well, this is how it's likely going to look so people can self-select in or not. And you can find out quickly what people's motivations are back to the why and what they're trying to solve for.

You can have older physicians who have built this practice for 30 years and are looking for a partner to help them transition it. That is one strategy. You have people who might be earlier in their careers and aggressively want to roll out their region, but know that going from one site to four sites in the Michigan market would be hard for them to do a loan and want a partner. So ownership alignment and just a candid dialogue about what's going to success look like for you and for us is probably number one. The second thing, we obviously spent a lot of time looking at the financials and understanding where the company has been, what's the organic growth been? And we look at doctor retention, staff retention and understand how long people have been there, how they try and understand as much as we can from the outside, how well they get along and just get a sense of the practice and where it might go.

In terms of red flags, the flip side of the lack ownership or lack of alignment can be seen pretty quickly from turnover, from cultural issues, from coding and compliance areas. The other area that I just as people think about value back to it being a one-ish time, yes, you should get the right value for your business and people like Clint are going to help you do that. On the flip side, if you have someone overpay and everyone's upset on day two, that's not good either, and you have something called the quality of earnings or presentation of your financials. A lot of folks basically run their business on a cash basis, QuickBooks pay their taxes. Someone like Clint's going to come in and translate that information for someone like us to be into revenue, EBITDA, all these terms, and they'll make adjustments.

And those adjustments are often a doctor who might be making let's say round number, a million dollars of comp saying, well, going forward, I want to make 500,000 comp and that delta a multiple gets applied to it and that's part of the purchase price. Well, instead the doctor said, well, I only want to make a 100,000, and so apply that multiple to 900,000 spread, that to someone like me feels very aggressive because that's too far from how they've been living. So you need to set it up ideally so that we call it income repair, but a doctor who's making X one, two years ideally down the road back to making X because they've now been able to refocus on medicine and adding ancillaries, whether that's X or MOS or other things to the practice in the case of dermatology. So that's kind of like what we look for here.

David Mandell:

Those are some great insights. And the last one you were talking about in terms of income is how OJM often gets involved. And just like you had said before, I really like when firms will hire Clint because they'll come, they'll get their financials together right, maybe they'll prepare and start to do some things even before they come to the market so they're ready to be properly valued, et cetera. Where the way OJM helps clients is to have them understand and run financial planning with our software, et cetera, to say, what does it look like when your income comes down, and what does it look like when you get this check and how are you going to use that? And maybe another bite of the apple in the future, does it help you particular physician meet your particular physician and your spouse goals?

Because deal could be great on paper, but it's got to fit for the doc. And I think what you're saying is you want it to fit for the doc too because they need to be productive after this fact. It doesn't help anyone for a deal to be too heavily overpaid or underpaid. I mean, that's sort of lesson I'm getting is obviously there's going to be five different buyers of a house, five different sellers, different pricing, but ideally it's not too lopsided because that doesn't really work for anyone long-term. Is that a lesson kind of, Matt, that you concur with?

Matt Ebbel:

Lately. And a lot of the management teams that I've dealt with these companies have been looking for someone like you to work with their physicians because they get a check and now they don't know what to do with it. And creating a financial plan, equities, fixed income, et cetera, that supplements their go forward plan, including hard to value asset because they will have a pool of capital that they entrust to someone like you, but they'll also have a stake in this new business. And I've seen a lot of financial planners advise physicians will sell that stake because it's a levered small cap equity, and in the case of MedVet, people who've held that stock, it's up over 20 times in the last seven years and they've had multiple chances of liquidity. So it's been a great investment for exceeding what they might've earned in the stock market. And then there's been other cases where that equity has gone probably bankrupt. So you need to have someone who can help you navigate that.

David Mandell:

Right. Yeah, I agree. And we can always talk offline if you have clients you want to refer us, we're always happy to, but that's the role we play. And it relates to what you were saying, so I'm glad you brought that up. Clint, advising practices, getting them ready for these deals. What are some of the success factors, things you say, oh, I like this, they have X together, or red flags. Oh, this is going to be hard sledding with this practice. They may seem at first blush to be a good target, but now we're digging in and I'm seeing some things I don't like. So give us a couple of ideas on that.

Clint Bundy:

Yeah, I kind of use three legs of the stool analogy. Sometimes I'll throw a fourth leg in there, but when we're advising a practice owner, even before we're engaged, we're assessing stability, profitability, growth. And then the fourth leg sometimes I'll throw in there is scale. Do they have scale? So stability, do they have a stable base of providers? Do they have, is their performance relatively stable or has it been incredibly volatile? Do they have a nice facilities, good stable demographic market, they're in profitable, are they running profitable operations? I mean that usually for whether you're an investment banker like me or someone like Matt, that usually doesn't take very long to, once we get a hand on the right information from a practice owner if they want to share it, and then growth. Do they have a history of prior growth? And we do a lot of this as an investment banker, work with a client, can we help articulate the story of how they can grow in the future, including with a new partner or new owner?

Because at the end of the day, let's face it, a buyer is buying the future. They're not buying the past. So if we can't articulate the story and I'm in the story business at the end of the day on behalf of my clients, if we can't articulate the story about how the business is going to stay stable, profitable, and is going to grow, then it makes it tougher for us to drive value in a process. Sometimes, as I mentioned earlier, I'll throw in scale as a fourth leg of the stool, but that being said, I don't overemphasize scale because we kind of flex up or flex down. We work with some really strong smaller solo practitioners or just a few providers all the way up to the multi provider multi-location, and you don't necessarily have to have scale to be considered a strong company. So scale's one of those. I'll say it's a nice to have and not must have.

David Mandell:

Yeah, that tracks. And I think I've heard you say some of these things before when we've spoken together, so that makes sense. Matt, I know based on what you've said before that oftentimes you're not interacting directly with the practice, meaning that might come through the platform. But again, you're in the background, and if I'm listening to this and I'm a physician or a dentist or a vet and I'm getting either solicited or I'm out there trying to, I think there's a deal that makes sense for my practice. Beyond the platform, what should they be looking for? What are some things they should be thinking about when understanding the capital partner in the deal? Your role.

Matt Ebbel:

Yeah. I mean I think you're going to see a platform likely and then behind them will be one or more financial sponsors depending on the size of the business. And they need to look at to the extent they can, who's the individual [inaudible 00:38:37] the investment, what's their track record, where else have they been involved, which companies have they been involved with? Have those been successful companies, have they gone bankrupt, et cetera. You can do that due diligence with Google pretty easily these days. But I think most importantly you need to try and understand the alignment and the CEO can tell you this or the team that's representing the platform, what's the vision, what's the alignment between the sponsor and that platform for building that company? And I think there's three major stakeholders in a lot of these businesses. It's the providers, it's the patients, and then finally in non-veterinary it's the payers.

And how is this business serving each of those constituencies and is it medically focused? Is it medically led? MedVet, veterinary owned and veterinary led, but Docs, the role that the medical executive board has is equal and probably more so in the operations of that business then the core board that I sit on for the business and how we go and execute marketplace. And for me, we have lower margins because we have higher organic growth and we have higher focus on medical quality. And that is a good trade-off. There are other financial sponsors out there that want to dictate schedules and visits per day and run it like a widget business. These are people businesses and there's some physicians for whom 20 appointments is the right number in a day. There's others that 40 might be the right number. There's even higher. So you really got to focus on I think the platform's commitment and alignment and values with your own and make sure the sponsor backs that up with how they allocate resources to the business.

David Mandell:

Yeah, what you're saying is so important, I'm sure to the docs listening to this, right? This is as before this kind of started, I think there was a lot of skepticism among physicians and dentists and what have you to say, ah, we don't need Wall Street messing with us coming in and we don't need bosses coming in telling us what to do and how to practice medicine and getting in between me and the patient. And none of us as patients would want that, right? But again, for the listeners, I think it's season two or three, I'll make sure I noted in the show notes, but we had an episode where it was an orthopedic surgeon and the CEO of the practice and they're two years out from doing a deal. And one of the things they said was, we did this deal before COVID and then COVID hit and it's like, okay, how are we going to see patients now and how are we going to do procedures now and how are we going to take care of our patients?

And one of the things that really came out of that episode was their satisfaction, I would even say a better word than that, they're being pleased with how their capital partner and platform allowed them to practice the best medicine they could when this totally unforeseen event hit them, which was COVID and all of its restrictions and be able to even practice medicine and then all the things about how to keep a practice compliant and sanitary and all that. So I'm sure that there's a range out there of folks like you referenced. Not everybody is as amenable to putting medicine first, but I think for the docs who make that a priority, I think what you're saying is there are capital partners out there who do see it that way, and that's good for them to hear because we don't want people not doing a deal or not even considering because they don't think that exists. And hopefully there's enough knowledge out there to know that there is, but you got to do the work and find the right people to partner up with. So I appreciate your comments there.

Clint, when you're advising practices and a couple offers come in or you're out, even probably more relevant, you're out there trying to get a couple offers for the practice and see what's out there, how do you advise practices to evaluate that? Meaning, I doubt you're going to say this, but is it the highest number always wins, but what are the factors that help that you are helping the docs and the owners to evaluate and decide?

Clint Bundy:

Well, I'm glad you used offers in the plural because I think that's a key concept here, which is something that many seasoned business owners who've sold companies before, and I think Matt can disagree me once, but I think most private equity groups that agree with me when it's time for them to sell is that to determine the best market and have the best position of strength, you really need to run some kind of process and have a competition involved.

And really at the end of the day, I mean talking about valuation ranges and buyer options, I mean it's all, as an investment maker, we're very accustomed to talking a great deal about that in the run-up to what we would call a letter of intent date when we get offers in. But the truth is [inaudible 00:44:14] when you get offers in after buyers have done a sufficient amount of due diligence on the company, and it's really the onus is on the seller and it's sellers, investment bankers that educate the buyers so that when they give offers, they're educated offers and not just kind of a fly by night piece of paper with some numbers on there. But what we do is we like to sit down with our clients when we get the offers in.

And by that point, ideally we've done a good job interviewing the buyers as they've done a good job of interviewing our client and really assess the quantitative, which are the numbers on the page, the LOI, that's transaction value, that's the structure of the transaction, that's any terms around legal document terms such as reps [inaudible 00:45:02] and if we've fleshed some of that out in the purchase in the letter of intent, number of other attributes that we could frankly have a little separate podcast on LOI terms. So we certainly look at the quantitative, the measurables, but we also look at the, let's call the more intangible. And a big one there is a term we use in our industry certainty to close, which is, okay, it's great to see these numbers and it's great to see a couple that are maybe head above heels, the others, but now we have to apply the certainty to close of those buyers relative to their offers.

And the reality is that part of this is being beneficial, being in the industry for a long time and known a lot of the players, a good investment banker will know and be able to assess and advise their clients who has the higher certainty to close. There may be one above everybody else, so there may be several that are above the others. And frankly, we have to find a way to probability weight that. We have certainly had transactions before where the highest offer has not been selected to go under LOI with because frankly, a big reason for that is the certainty to close question. So hopefully that gives you a little bit of guidance on how we look at it from our chair.

David Mandell:

That makes sense. And this is another sort of element that I think if, again, back to the one-ish, I'm going to come back to that, I love that, nature of this kind of deal that if you're doing it on your own, even if you have a good lawyer, necessarily an M&A lawyer has done a lot of deals, but even if you have a good CPA's help you get your EBITDA together in your books, they're not going to be able to apply that factor. So now that that is kind of out and nobody wants to go down a deal in all that expense and time and then realize, hey, this was a firm that had a reputation not to get it done. And you could have known that from the beginning had you known or had you been advised properly. So that I think is something that probably our listeners hadn't heard before. But of course all the elements you're saying, but that one particularly jumped out at me.

Matt, back to you. I've got a two part question for you, and it relates to what we were just talking to Clint about. So if two offers are identical financially, and I know this is normally not, you're doing it directly, it's through intermediaries or platforms, but thinking of the doc, what factors do you think a doc or practice should consider? Right? So sort of similar to the question I asked Clint, and then also, how would they evaluate offers from different strategic approaches that are backed by the PE firms? You've alluded to this a little bit that you want alignment there, but maybe just putting on the hypothetical doc listening to this, there's two offers. What should, from your perspective as a private equity principal, how would you advise them if you were helping them make decisions that way?

Matt Ebbel:

I think if you have two offers, three offers, and they all are very close, you have to really say there's cash. And that's pretty easy to evaluate today. There's often equity and you should have each potential person explain how they value their equity today, how they're valuing that relative to how they value your equity, and then what is their own case for the increase in value of that equity and do you believe it? And someone like Clint can help you judge the relative stories behind each of those equity pieces. But beyond the financials, I think I go back to really focusing on cultural alignment. What is the mentality of your new business partner? What is their track record? Then I look at platform resources, what do they have in terms of corporate spend that's going to benefit your practice? I've seen businesses that run on three or 4% of revenue for their corporate spend and 10, 11, 12%.

Often something in the middle is right. You don't want a business spending too much on corporate and going to over-engineer things. And you also don't want to sign up with a group that is just a little bit captain kangaroo where there's too many practices and not enough people keeping track of things. So getting the resources right. And then finally, I think anyone that believes things like AI are going to dramatically impact really all parts of society and in industry, I think you want to find a partner who's leveraging technology and data has a strategy there and really has a vision for how to implement technology in a human way to make these businesses better.

And then beyond that, I would just encourage, as you think through different offers to do what I call conducting reverse due diligence, ask for reference calls with providers who have sold their businesses to this platform. Usually you're not the first. If you are the first, you're up. That's something you have to be [inaudible 00:50:25] and there'll be pluses and minuses with that type of transaction. And then you should also be able to speak with the vendors in the industry. It might be the pharma sales person who's been calling on your practice and others might be the lab who serves you and others. But there's lots of ways you should be able to do your own due diligence on these potential partners. And I would encourage you to do so.

David Mandell:

There's a lot of good ideas there. And again, I'm excited because we haven't heard this on the podcast before. The corporate spend concept I think is a really important one. You want the back of the house to be well-equipped, but you don't want it too heavy because that's just taking it out of everybody's pocket. Certainly I'm a believer in the way AI is changing and will continue to change all businesses, and that shouldn't be ignored. The reverse due diligence is probably something most docs would think of, but I can't overemphasize it, which is, if you're not the first deal, talk to docs who've been there and how are they like it? And they'll give you often doc to doc, especially if there's any connection, but even if there isn't, they'll give you the honest go out for beer and/or get them on the phone and they'll probably be pretty forthright with you.

And I also really like the idea of the debt due diligence, including outside industry players because we all know that whether it's a drug rep or it's a OR nurse who understands what's going on in the OR, people who are one sort of step removed but still part of, they know how that business or how that doc performs or how, people know. So if it is been going, it doesn't even have to be the physician. It could be other folks around that, those practices that you could get some good perspective in. So I loved all those ideas and they're all new to the podcast, so thank you for that, Matt. All right. We're going to end now with, I'm going to give the same question to each of you. And since we just did Matt, we'll start with Clint. Where do you see things going over the next few years with regard to M&A and medical/dental SaaS veterinary?

Clint Bundy:

I guess I'll start with my crystal ball is better than nobody else's, but I'll give my best shot on goal. Look, speaking for our company, we're still very bullish about the healthcare services and physician practice markets. Some segments of physician practice management such as dermatology are a little more consolidated than others, such as say med spa. But that doesn't mean they're still a lot of room for investment in even the more consolidated segments. Obviously these are industries that are very much a backbone of the US economy and are delivering value added life-changing life care services to their patients.

And we think there's a role not just for investment bankers, but also for the, let's call it the private equity alternative. Although at the end of the day, we're not, Bundy Group, we're not wedded to selling to a private equity group or a private equity backed platform. But the truth is that is a big driver today of a lot of what's going on in the M&A market for healthcare and physician practice management. And I don't see that a big at anytime in the near future. So yes, the macroeconomic challenges right now could soften the M&A markets a little bit. It already has for the past year and could continue a little bit more into 24, but we're still very bullish based on what we're seeing in our pipeline.

David Mandell:

Thank you. Thank you, Clint. And Matt, your thoughts?

Matt Ebbel:

I think 2023, a lot of the headlines are the deal volumes are down somewhere around 70% at the platform level. A lot of the platforms are still busy trying to buy individual physician practices, but I haven't seen the data, but I imagine that has slowed as well relative to the go-go days of 2018, 19, 2020, 2021. If I think about the next 2, 3, 4 years, I think that's going to probably increase in pace off of the 2023 pace interest rates that moved up from close to zero to five and a quarter to five and a half percent. That's the quickest, most steep move in interest rates I think potentially ever in US history. And it just caused everyone to pause and reflect. I think we're near or at the tail end of that. So, but on top of that base rate, platforms are paying a spread because they're smaller businesses that have credit risk to them.

So the people lending money to us are charging us nine, 10, 11% at the moment. And if interest rates come down, they'll go down proportionately. But that is a force when we think about do we part with 10 million of cash that's going to cost us, or borrow 10 million to buy this business that'll cost us a million on a recurring basis. We need to think about the earning stream that will come from the practice and how that will contribute to paying that interest expense. So I think that that's a very real thing going on.

On the flip side, I hear a lot of practices that are dealing with what I described earlier on wage inflation pressure from payers. And the price may be at the same price that they might've received before, but their desire or motivation to join someone else to collaborate and share some of the operational burdens is higher. So I think buyers and sellers are finding themselves, again, market conditions are stabilizing, and I think it will remain as Clint said, a very active area for private equity. I think we'll start to see a few of the bigger companies such as Aspen Dental in the dental space or NDA in the vet space, try and go public in the next one to two years, and that will set a benchmark, which the private markets will then key off of.

David Mandell:

Excellent insights. And again, I like the fact that you referred back to the interest rates in that environment and how it kind of ties together. And it'll be interesting to see if some of these entities do go public and that will spur even more potential interest in it. So really interesting conversation. I knew that it would be, I knew we'd hear some things that we haven't heard before but really delivered. So Matt and Clint, thank you so much for being on. I really appreciate it.

Matt Ebbel:

Thank David. Thanks Clint.

David Mandell:

So to all the listeners, thank you for being on. A couple of housekeeping. If you like what you heard and you like what we were doing, give us that five star rating. I know we've gotten a number, we have a pretty healthy number of those, which is great. Tell your friends and colleagues about us, follow us in the different platforms that you find us on. And if you're a physician or industry expert who has something interesting to say, I'm always open to new guests. We certainly are well ahead of where we were last year in terms of getting segments in the can, but I'm open to new guests, so don't be shy of reaching out. And with that, we'll have another episode in two weeks. Thanks for listening.