



Episode 118: Opportunities in Lower Middle-Market Healthcare, With Ben Mackay

Episode Summary

Lower middle-market private equity in government-reimbursed healthcare requires a different playbook — one that balances controlling ownership with founder retention to build long-term value. Evolve Capital has become a subject matter expert in the Medicare-reimbursed home healthcare space, and principal [Ben Mackay](#) shares the playbooks with McGuireWoods partner and host [Geoff Cockrell](#).

Tune in for Ben's insights about other opportunities in the market — including home healthcare with attached hospice, autism services and specialty pharmacies that cater to pets.

Transcript

Voice over (00:00):

This is The Corner Series, a McGuireWoods series, exploring business and legal issues prevalent in today's private equity industry. Tune in with McGuireWoods partner, Geoff Cockrell, as he and specialists share real-world insight to help enhance your knowledge.

Geoff Cockrell (00:20):

Thank you for joining another episode of The Corner Series. I'm your host, Geoff Cockrell. Here at The Corner Series, we try to bring together deal makers and thought leaders at the corner of healthcare and private equity. Today I'm joined by Ben Mackay, Principal at Evolve Capital. Ben, maybe give a little introduction of yourself and Evolve and then we can jump into a discussion.

Ben Mackay (00:40):

Thanks, Geoff, and thanks for having me on. So, my name is Ben Mackay. I got started in the, I guess we call it the lower middle market private equity space back in 2008, starting with Evolve Capital down in Dallas. And really started on their deal sourcing side of things. And Evolve's always

been focused on healthcare mergers and acquisitions. So buying companies typically from founders or closely held ownership in the sort of non-facility based Medicare, Medicaid, generally government reimbursed healthcare services space.

(01:18):

And we talk about it in terms of buying the company, which I always catch myself when I say that. We are buying the business, but we also always talk about it and think about it in terms of a partnership as well. Because our structure, even though we're buying the company, controlling interest in a company, usually the founder or the owners would retain some ownership alongside of us going forward. We do think of it as a partnership as well.

Geoff Cockrell (01:46):

You mentioned provider-based government reimbursement. That's still a pretty wide market. What sectors within that are appealing to you and why?

Ben Mackay (01:56):

Yeah, I think Evolve really kind of got our start really in the Medicare and Medicaid, home healthcare side of things. So that's just a space over the years, 20 something years of doing it where we've become really a, at least we think anyway, a subject matter expert in the Medicare, home healthcare space. We've built up a number of large Medicare reimbursed home healthcare companies. And we like that space in particular because it's usually thought of as the least cost provider of care.

(02:26):

So if you think about it, if we can help somebody in their home with a nurse and have that reimbursed through Medicare, then hopefully we can keep that person out of the hospital. And it's a lot less expensive to treat that patient or manage their condition or whatever they have going on so that they stay out of the hospital. Because once a patient ends up in the hospital, especially for a Medicare patient, it ends up being much more expensive on the system as a whole as well. So, we're sort of there because we feel like we're doing a good thing on a few levels.

Geoff Cockrell (02:59):

Staying with the home health subsector, it's definitely a sector that has had ups and downs with some of the evolving headwinds in that being migration towards dual eligible, so Medicare and Medicaid eligible patients getting pushed into managed care programs, which have their own challenges. There have been reimbursement pressures from time to time. Even though it is certainly almost always the most cost-effective sector, there still can be reimbursement pressures and then some specters around vertical integration of health systems maybe leaning back into internalizing some of those functions. How have you thought about navigating some of those headwinds? Or do you think that those have largely passed or been reflected in valuations such that they're just part of the landscape? How do you think about some of those headwinds?

Ben Mackay (03:53):

Sure. So, the market when in the mid-2000s I think government reimbursed Medicare companies were actually making pretty good money in the bottom line. And since then, there've been a number of rate cuts. And I think it's sort of maybe where it should be now, where if you're going to be running a business, you got to be able to make a little bit of money on the bottom line. And I think it's gotten whittled down to that at this point where... So I think as far as rate cuts are concerned, I would be concerned if there were more rate cuts for sure. Because I don't think, certainly the way we operate, we try to operate pretty lean and pretty efficient. And it's not a super high margin bottom line business like it was. It was certainly more profitable in the early 2000s than it is now.

(04:42):

I think it's interesting now where with current administration, I'm just starting to see actually quite a bit more deal flow on the Medicare and Medicaid home healthcare side of things. And I think there are, I don't know for sure, but it's a question I'm starting to ask people. Are people concerned about, I guess what you would generally call entitlement spending from the government? These big programs, are they going to get cut or not? And what effect is that going to have on rates going forward or availability to patient populations? And I think nobody really knows yet, but I think that's something that we're all keeping our eyes on.

Geoff Cockrell (05:22):

How would you describe the home health market in the sense of for a long time, the home health market was very unconsolidated. And by unconsolidated, to me, that's been an extrapolation of that there were very few barriers to entry. So, two nurses get a license to your home health agency and they could just pop up nilly willy. And then it was also an environment where referrals coming out of a hospital were not an orchestrated sequence. And it was largely bringing doughnuts to the discharge office that was the pathway to getting those referrals. But this has become a more kind of professionalized market. And the reimbursement has been clipped over time in ways that made just everybody jumping into it more difficult. But kind of adding up those pieces, what does the consolidation of that market look like? And where the opportunities for groups like you?

Ben Mackay (06:17):

Yeah, I think like all markets, there's a few really large players and then I think stepping down, you kind of drop into where we play private equity. And there're various sizes of those. I mean, we're looking at businesses from sort of the two to 5 million EBITDA range, which might be like 15 million in revenue or so up to maybe 50 million in revenue, as far as platforms. But we're still looking at add-on acquisitions and we're still seeing quite a few really small... You mentioned maybe a couple of nurses getting together and starting an agency. I think that's still happening and there's still some agencies popping up here and there. And there's still a lot of little agencies here and there that are out there.

(07:03):

I think they're trying to figure out how do they grow organically. Because you've got more professionalized sort of people in the market, I guess like we would be. Where we've kind of got a playbook as far as how we're going to grow in a market and provide really high quality care. And making sure that those various stats like preventing readmits into the hospital. Or we really just try to run our operations so that it's the best for the patient and best for the system, which is hard to do, I think really hard when you're starting up and you're really small. And so, I guess those are my thoughts on that.

Geoff Cockrell (07:40):

And once you get a little bit of scale, whether in general or in a particular market, what are some of the advantages that you have or opportunities that prevent... I see some kind of home health thesis is bending towards expanding into hospice, some not. How do you think about some of those lateral expansions?

Ben Mackay (08:00):

Sure. I mean, there's always the cross-referral side of things where it's like, okay, if we have a sort of a home healthcare company that's got a little bit of scale, could we get a hospice that is attached to it? And then you can refer, cross-refer a little bit. So from a business perspective anyway, the patient is, you kind of follow that patient through a life cycle anyway.

(08:23):

There's another case, it's just you go in and try to buy a Medicaid reimbursed business and then get a Medicare license and grow that way. And then you get two different Medicare and Medicaid reimbursed kind of a platform. So, you diversify yourself a little bit. And I think when you get a little bit of scale to be able to do that, obviously limits your downside a little bit. And lets you maybe take a little bit more risk on the growth side because you're not as worried about your business tanking if someone makes one decision on one reimbursement model.

Geoff Cockrell (08:57):

When we were getting ready for this, you were mentioning some of the other areas of interest. I think it'd be good to explore that a little bit. You mentioned a broad thesis in behavioral health, which obviously covers a lot of waterfront. Which areas within behavioral health do you find interesting and why?

Ben Mackay (09:15):

So, we've always found the autism services space to be interesting, so the ABA space. Our challenge with that, and I think probably a challenge for a lot of people is from a purely financial perspective, those companies tend to trade at fairly high valuations. And so, it's sort of hard for us to get into

those. But we do have a platform now in Tennessee that we really like and we're working on growing. But we're starting off small and trying to grow organically with that one.

Geoff Cockrell (09:43):

And I hear that refrain a lot in some of those kind of sectors where you can quickly get to high valuation multiples even at low size. Within autism services, what are the opportunities for organic growth and what does that look like?

Ben Mackay (10:02):

I think it's been a hot topic in general news, I feel like, in the last obviously six months, nine months. But certainly in our market intensity, there's a long waiting list for folks that are looking for autism services. And I think that exists in other states as well. So, I think there's a real need for that service and there's just not enough providers right now. I think that's really the opportunity for organic growth, if we can just really expand our ability to provide services to a broader population.

Geoff Cockrell (10:36):

And you kind of touched on it, but I hear this a lot in some of these areas, home health included, is that the gating item on growth is not the market, it's a labor problem. In behavioral health, how do you think about a strategy around recruitment, retention, alignment to the extent that that comes into play? How do you think about solving that puzzle?

Ben Mackay (10:59):

Yeah, I think the other, the thing dynamic out there is rising wage rates and trying to figure out, well, how do you attract these people but still run a good business? And I think that's a moving landscape right now. And then trying to find people that are trained and experienced, skilled care providers is also a challenge for us. So, I think we're thinking through that and you've got some people think of, they call it a university like, Hey, let's start training people that can come work for us and have a training program or a training regimen. I think there's a lot of ideas out there about it. But we haven't really figured that one out yet, but it's a challenging dynamic.

Geoff Cockrell (11:36):

And you mentioned that your platform is in Tennessee. And Tennessee is obviously not all rural, but it has been a testing ground for some of the thesis that are built around extending care into less dense areas. Is that a feature that you're looking at? And how do you think some of the challenges and opportunities there?

Ben Mackay (11:55):

Yeah, we generally like the more rural healthcare side of things. One, I think we're just more places we like to spend time anyway. And I think it's also a patient population that can benefit probably more from the types of services, the businesses that we're interested in, whether it's home health, hospice,

or behavioral health type companies. I mean, so much of America is rural and it's a long drive to a hospital or a care facility or something like that.

(12:27):

So if we can help those people, again, back to our original thesis, there's a lot of positives around all of these non-facility-based healthcare models in terms of just helping people in need. Also providing, being sort of a least cost writer of care on the system. So yeah, staying focused on the rural side of things is something we like to do.

(12:48):

One dynamic out there that I've heard about is there's a concern about critical access hospitals and sort of the staffing levels there. And whether those are going to be able to stay open and what kind of... I think that's really on the Medicaid side maybe. There might even be more of an opportunity or more of a need for folks like us to be able to provide care in rural environments.

Geoff Cockrell (13:08):

Yeah, it's been an elusive solution in a lot of contexts as far as extending into less dense areas using either a hub and spoke or other modalities of extending care where there's fewer providers and fewer patients. Definitely been difficult, but also definitely in the sweet spot of investment ideas that are centered around answering the core concerns from a healthcare policy perspective of improving access, improving outcomes, and lowering system cost. There's certainly lots of reasons to keep looking at those spaces. Beyond behavioral health and home health, what other healthcare sectors do you find interesting, either that you've made investments or that you're looking at?

Ben Mackay (13:55):

Yeah, the other main platform we have in healthcare services is an IDD business, so group homes for developmentally disabled folks. Typically, Medicaid waiver reimbursed. So, we've been growing that for quite a while up through the Midwest. And then other than that, just generally looking for healthcare service businesses, again non-facility based that are sort of not as mainstream. There's one that we've been kind of batting around, intensive outpatient, IOP, which is a sort of interesting space. We're just learning more about it.

Geoff Cockrell (14:28):

Maybe describe that a little bit more. I'm not sure I've seen a deal in that kind of intersection.

Ben Mackay (14:33):

There've been a couple of them, and I say we're non-facility-based, but these ones, a lot of times they have a real estate component where someone is intensive outpatient where it's like the patient stays at a facility or stays in a larger building of some kind or campus or something. And I think some of the reimbursement goes toward the real estate side, some of it goes toward the patient side. And we

haven't been totally comfortable with it and figure it out. But it can be anything from behavioral issues, it could be sort of a unique addiction type, but not your standard sort of residential 12 step programs. So, it's a little different. So, that's an area where we're kind of poking around in to learn more.

Geoff Cockrell (15:12):

Ben, you also, when we were prepping, mentioned an area that you're looking into from the specialty pharmacy direction. Which that can take a lot of different ideas, whether serving particular facilities or serving particular disease states or otherwise. What are your thoughts from a specialty pharmacy perspective, and what are you looking at?

Ben Mackay (15:33):

Yeah, in the past we've looked at, I remember we looked at a compounding pharmacy for horses, which was pretty interesting. And the dynamics around compounding pharmacies are complex. And I think as they relate to animals, it's really interesting because at the heart of compounding, you're creating a patient specific solution. And so with a horse, for instance, there may be a drug that's in a pill form, but you're not going to give a horse a pill usually. So, it might need to be changed into being injectable or be a cream or something like that. And it also is going to have to be a lot stronger than something that's used on a human, for instance. And then you could take the same thing and try to use it on a cat and it's got to be a lot lower of strength.

(16:15):

And so I think there's a lot of value there for specialty pharma, as far as it relates to animals. And then we had a business called BioLogos, which was a couple of years ago, we sold it. But they were making sterile filtered media for using animal vaccines. And all these sort of interesting, not maybe non-human type pharmacy businesses are pretty interesting.

Geoff Cockrell (16:39):

Super interesting. The explosion of kind private equity-backed vet businesses have really expanded the market of services for animals that people are willing to consume. I know it has in my household, just the willingness to spend money on kind of pet health needs is dramatically increased. And it has kind of created markets for downstream elements.

(17:04):

And the other kind of dynamic around some of the specialty pharmacy businesses that are animal centered is there can be questions on whether or not some of that stuff is even within the purview of the FDA. I know there's been fights along the way as to the degree to which the FDA has oversight of that, either as a drug or as food or over what, but certainly lots of room for openings. And other than some of those kind of FDA type oversight, since it's not government reimbursed, you have far less regulatory restrictions. And you can set up businesses in ways that you might, if it was not a healthcare business, as far as aligning incentives in ways that if you're talking about human patients

might be very, very problematic, but in the context of animals might be completely fine. How's that kind of informed some of your thinking on this?

Ben Mackay (17:55):

Yeah, absolutely. I mean, to be honest, we haven't looked at a deal in the space in a few years, but I think we find it interesting. So, I'm not fully up to speed on the FDA side of things. Back when we looked at it in the past, we kind of liked it because of the relatively low regulatory side of things. I think the challenge was the business we were looking at was making pretty high-end stuff for horses. So it's like, man, if you mess up, not only is the horse sick or maybe no longer living, but also it's a huge expense for the owner of that animal.

(18:28):

So I think people are going to keep spending money on their pets, for instance. And certainly if we're talking about race horses or something like that, that's a whole different universe of super expensive, very competitive environments. And it's just they've got to keep those animals in top shape and it's challenging to do with traditional medicine. So, compounding makes a lot of sense.

Geoff Cockrell (18:53):

Ben, I think we'll probably end it there. This has been a super interesting discussion and really want to thank you for joining. It's been a ton of fun.

Ben Mackay (19:01):

Yeah, thanks for having me.

Voice over (19:05):

Thank you for joining us on this installment of The Corner Series. To learn more about today's discussion, please email host Geoff Cockrell at gcockrell@maguirewoods.com. We look forward to hearing from you.

(19:18):

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