McGuireWoods

THE CORNER SERIES

Episode 98: The Floor vs. Ceiling Shift in Healthcare M&A, With TUSK Practice Sales

Episode Summary

Today, sellers of healthcare practices look for a higher floor than ceiling, explains Ryan Mingus, managing director of TUSK Practice Sales, a healthcare M&A advisory firm. Ryan teams up with director Connor Jorgensen for a discussion about how practice owners' priorities have shifted from maximizing valuation to seeking operational support and sustainability.

Speaking with McGuireWoods partner and host Geoff Cockrell, Ryan and Connor describe how joint venture structures have become increasingly popular across specialties, from dental to GI and dermatology, as sellers prioritize ongoing distributions over potentially risky holding company equity.

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 (00:19):

Thank you for joining another episode of The Corner Series. I'm your host, Geoff Cockrell, partner at McGuireWoods. Here at The Corner Series, we try to bring together deal makers and thought leaders at the intersection of healthcare and private equity, talk about transaction trends, different sectors. Today I'm thrilled to be joined by two folks from TUSK Partners who we've done a bunch of deals with over time. TUSK is one of the leading healthcare investment banking firms. They, for a while did a lot of dental, they now have a much broader repertoire of provider arenas that they work in. But I'm joined by Ryan Mingus, managing director, and Connor Jorgensen, a director at TUSK. Ryan, if you could introduce yourself and then Connor, if you could as well, and then we'll jump into some questions.

Ryan Mingus (01:03):

Sure. Thanks Geoff. Also want to thank you for being here, longtime listeners of the pod and love working with McGuireWoods in this space. But Ryan Mingus, managing director here at TUSK. I've been here for a little over five years and a recent partner. My entire career has been in the healthcare sector, both in business development strategy and maybe in the last decade or so, mergers and acquisitions. So have helped TUSK in multiple efforts, business development and actual running deals and overseeing the deal team. And so really excited to speak with you guys today.

Geoff Cockrell (01:33):

And Connor, if you could introduce yourself.

Connor Jorgensen (01:35):

Yeah, great to be here, Geoff. Thank you again for the time and the opportunity. I've been in the healthcare space for well over a decade now, primarily focusing efforts in M&A activity, value creation, operational excellence. Actually, before joining TUSK, I was on the buy side for a large DSO. So I certainly have experience on the tips and tricks and the games that are played on the buy side and acquisition when it comes to smaller healthcare deals, but been here at TUSK for about two years now. And really my job at TUSK is educationally focused, where I work with doctors and healthcare owners every day to really give guidance and input and provide opportunities and pathways for a potential transaction to a private equity firm or a large DSO or MSO and what that means from a cultural perspective of financial outcome and support mechanisms as well.

Geoff Cockrell (02:25):

Connor, maybe we'll start with you. I feel like over the last few years, the characteristics of a typical seller provider group has evolved in terms of what they're interested in, what they're afraid of, what they're trying to accomplish. A few years ago it was all the money, and I feel like that has changed. Can you describe how you're seeing that evolution in the typical seller?

Connor Jorgensen (02:50):

Yeah, great question. And we certainly have seen the current seller evolve and change over the last couple of years. Traditionally speaking, we saw doctors come to us that were looking for that big payday and looking for the opportunity to monetize their life's work and exit to a large DSO or MSO. In today's environment, there's a lot that has changed. The inflationary environment, the Great Resignation, the inflationary ... Everything you can think of is creating a more challenging operating environment for these healthcare owners. And so we're really seeing three different types of clients coming to us.

(03:23):

One being the same client that we saw a couple of years ago, that they're towards the end of their career, they're looking to monetize their business and really trying to maximize their value in the trade.

(03:33):

Second, being more of a healthcare owner that's burnt out, they're fatigued, they're frustrated. It's been a really challenging environment for them and they're often saying, "Look, I love what I do, but I hate how I'm doing it. I need help. I need support. I need some sophistication to get me to the next level and continue to do what I'm doing and I need help from a larger organization to shelter from the storm."

(03:56):

And then the third, we're still seeing really healthy and successful practices coming to us and saying, "Look, I've got a great practice, I've got a great organization, but I want to get to the next level." And really the only way that you can get to the next level is with private equity sponsor, with that strategic buyer that's going to be able to help you get to the next level and grow the business. So we have absolutely seen the client avatar change pretty dramatically over the last few years, and again, an influx in those that are just challenged in the operational environment that they are today.

Geoff Cockrell (04:26):

Ryan, building on that, one of the pressures in provider services over the last couple of years has been labor pressures, whether that is retiring doctors or just a tight labor market. To what extent are individual practices feeling those same pressures and to what extent is a larger DSO able to mitigate those? Because that still seems to be a challenge, whether you're small or big. How are you seeing that play out?

Ryan Mingus (04:54):

Yeah, 100%. I think the labor market being what it is today, whether you're in the dental business, dermatology business, the behavioral health space, it's really that mid-level provider that is the most difficult to solve for. So in dentistry, that's hygienists. In dermatology or some others it might be PAs or NPs. And then also dental assistants or medical assistants, not quite mid-level, but still really integral to practice and having an amazing medical assistant or dental assistant can really drive the productivity of given producer, whether it be a dentist or a medical doctor.

(05:28):

I would say at the local level or the individual private practice level, they just don't have the same bandwidth and reach to get as many resumes in the door in order to sift through to go from 10 down to 2 really good candidates. They just don't have the bandwidth to scour the market the same way a larger organization can that has centralized services to do that and ultimately is always creating a bench and a stream of resumes to bring in the door. So I would say in the private practice level, they're doing it on an as-needed basis whereby in a DSO, they're really doing it, or an MSO, they're doing it all day every day trying to create this pool of good candidates. Then they're screening those candidates and getting them in front of the local practice once they're affiliated. So I think that it is still difficult, whether you're large or small, it's just a matter of resources and bandwidth within the four-wall practice versus a larger entity.

Connor Jorgensen (06:22):

I'd like to add to what Ryan had said because what we've seen from a large MSO or DSO space is that when you are recruiting for that talent or those team members, they are not as responsive as they once were. And so when you have a dedicated HR team that is able to respond to resumes, get interviews booked, and have these potential team members through your process immediately, where if you're doing it independently, you may not be responding to a resume until the lunch hour or until the next day. And so then you're losing that talent or that opportunity where if you have the centralized services like these organizations, you're able to get the talent in, in a much more efficient manner as well.

Geoff Cockrell (07:01):

Ryan, maybe coming back to you, I know you guys have been quite a bit in dental, but also in GI, dermatology, med spa, behavioral health, those are all very different in terms of their development, with maybe med spa and behavioral having more green space around them, GI, dermatology less so. Dental is always baffling in that it is the longest-running consolidation, but it seems like there's an endless supply of small practices. How would you segment those and what do the differences in them do to the market for transactions?

Ryan Mingus (07:37):

Yeah, I think we kind of use baseball references a lot. So in terms of a nine-inning game, first and foremost, each group is going to have a different ... What does full consolidation look like for dental? That might be very different than what full consolidation looks like for dermatology. So you can have a lifestyle dental practice for a very long time that isn't attractive to a DSO and there's not the same pressures within dental as there are in dermatology or GI where insurance companies are really driving a lot of the consolidation. So I would say in dental, let's start by saying maybe 65% or 70% of the market if they're affiliated with a larger entity, quantitates fully consolidated or maxed out consolidation with the other 30 or so percent coming in the form of solo practitioner on into perpetuity, whether that be an oral surgeon that's solo, an orthodontist that's solo, a GP that's solo, or somebody that just doesn't want to affiliate and their fee for service and they don't have any pressure from insurance to do so.

(08:35):

So I think dental will be the least consolidated at the end of the day, but I would say dental, call it, is 40% of the way there, 35% of the way to full consolidation. And then what we define as full consolidation is up for debate.

(08:49):

Dermatology, GI, those will be 95% affiliated or greater I think at the end of the day. So 100% consolidation for them will be a much larger percentage of all GI doctors or dermatologists. And I would say to your point, they're already in their second wave and probably in the seventh inning of that journey, perhaps top of the sixth, but I think that those two are pretty far along with dental being, call it the fourth inning.

(09:18):

And then you've got behavioral health and medaesthetics. Medaesthetics, I heard a stat that over 50% of all med spas are less than 3 years old, so just the total those businesses have even been operational is much lower. Behavioral health's a little bit older, but the demand for behavioral health is picking up so much and more providers are moving into the space. I think that that's probably in its second or third inning and med spas are in the first inning.

Geoff Cockrell (09:43):

So there's a couple of dynamics that come from that. I think they both affect the market. One is when something is in the late innings, what does that mean for people that have been acquiring in late innings? And then a separate but somewhat related question is just big consolidators. What happens with a $200 million EBITDA consolidated business? Who buys that? Where does it go? Maybe separating those into two questions and maybe the answer to them is the same, but Connor, for late inning sectors, how does that end? Do they become public? Does folks like Optum end up owning everything? Where does it go?

Connor Jorgensen (10:25):

Great question. And that's again, where there's some ambiguity and different avenues for each platform. We specifically have seen in the dental industry, there's some large platforms that have publicly stated that they're marching towards an IPO, and so their recap maturity is getting to a point where the next phase is going public. And then we just saw a large transaction in the orthodontics space where it's two consolidators, one consolidating the other. And so there are certainly different pathways and avenues that each organization is going, but let's just say that it certainly is a healthy pathway for the investors that have been part of the journey from the beginning as well.

Ryan Mingus (11:05):

I think speaking to dental specifically, you've got groups stating that they're going to go IPO. You've got a group like Heartland where their previous sponsor was a large pension fund, the Ontario Teachers Pension Fund. I think that that could be an acquirer for a good dental platform for many, many years. Pension funds need constant cashflow to put in the pockets of the pension holders and dental and many other healthcare factors for that are good candidates for that.

(11:31):

Then you've got in the healthcare space, insurance companies that could be the acquirers or holders. So the majority of medical groups could be owned by insurance companies. You could go in a for-profit hospital system, you could go public, which we've seen before with a couple of these One Medical and some of these concierge medicine businesses that aren't subject to the same pressures as your insurance-based medicine.

(11:53):

So there are a lot more options for at the end of the day, and I don't think there's going to be one holder of all medical businesses or one pathway for all dental businesses to ultimately get to. I think there's going to be an appetite for these large assets that turn off 15% EBITDA margins to shareholders and that have proven to be recession-resistant, pandemic-resistant, et cetera. Especially in the face of a lot of this international tariff turmoil that's going on, healthcare will probably continue to be a good place to park money.

Geoff Cockrell (12:29):

When I talk to larger consolidators, one of the puzzles they're trying to put together is around provider alignment, getting everybody rowing in the same direction. And there's a number of tools that could be utilized, fiddling with current compensation, profit sharing, income repair sort of ideas, Topco equity, JV equity. As you talk to sellers, what do you see sellers wanting from that alignment? What motivates them when they're approaching a transact?

Connor Jorgensen (13:02):

Yeah, Geoff, great question. So from the dental specific side of things and creating alignment with doctors and dentists who are looking to sell and partner with DSOs, OSOs, DPOs, you name it, obviously equity is a big play in that alignment. And we're certainly seeing a trend with equity both from the Holdco or the Topco level, but then really a push to joint venture level where these doctors are participating in the upside and the profitability growth of the partnership that they choose to join. And then again, that's looking at every category when it comes to economies of scale, but also increase in pair negotiations. With the right DSO partner and a joint venture structure, you can have a very significant financial outcome for the selling dentist, not just at the day of close, but as you're continuing to partner with 3, 5, 7 years down the line.

(13:53):

But the beautiful thing about joint venture equity is that you also have the ability to then liquidate that equity to the next generation of associates that are coming in. So it's creating this legacy of the practice that you've built. You are able to pass along that ownership structure to associates in the business where what we're seeing in today's market with associates is they're more risk-adverse, they don't have the financial means to come in and be a full owner in a business, and they really value job security, financial security and work-life balance. And so if they can be a minority owner in a larger organization, that's a really great opportunity for them long-term to be aligned in continuing to grow and develop the business that DSO acquired many years prior.

Ryan Mingus (14:39):

Thanks, Connor. I'll touch on some of the non-dental. I would say you used the term income repair. We've heard that a lot in the surgery center space. So a lot of these privately owned surgery centers don't have the same leverage with payers as perhaps one of these large surgery center management companies. So they're coming in and wanting to enter into a joint venture whereby the seller could sell 51% of that ASC to the management company and within 3 years time get them back to distributions that are similar to 100% of the practice today. So because they can increase the insurance rates so much, single specialty like GI or some of those other single specialty ambulatory surgery centers, it's quite easy for them to come in and do that. And by owning 49%, they get to alleviate some of the administrative headache of owning 100% of the practice, but within 3 years time, they're earning the same amount of distributions as they were when they owned 100%. So that's happening there.

(15:37):

I would say joint venture has also become a trend in the healthcare space, and I think it was definitely late to the game, whereas dental joint venture has been for a very long time. In healthcare, a lot of those deals with these groups were not joint venture-centric for medical groups or dermatology practices, et cetera. So they're finding that there's better risk sharing.

(15:57):

Now, the downside is for those LPs and the shareholders, is when you have a lot of joint venture holders, the returns to those LPs is likely going to be muted a little bit, but the likelihood of them getting it is much greater because you've got greater alignment from the doctors that sold with the management company that owns them.

Geoff Cockrell (16:16):

Ryan, following up with you. There have been a number of very visible transactions that have not gone swimmingly, whether that is the lender ending up owning the business or distress sale situations, and one of the implications of that can be depending on some of the factors in that event, a material or complete loss of value of rollover equity. How has the optics of those events impacted sellers' views at the time of transaction? Is there still the same faith in the upside value of a second bite at the apple, or are they more gun shy on that and focused more on current compensation mechanics, whether that is raw compensation or interim distribution economics out of a JV structure? How have some of the misses impacted seller perspectives?

Ryan Mingus (17:14):

Yeah, it has impacted the conversations that we have today tremendously. A lot of these are very high profile, very household names within dentistry that have, for all intents and purposes, gone under and all Holdco equity has been wiped out, and that's reverberated through the market. And as a result, when you have somebody that's coming to us, that's why we're not getting those same folks coming to us with LOIs in hand ready to do a deal. They're coming to us out of need, whether it be they know they need a backwards plan to get their deal done in time for them to maximize valuation or they're just having a difficult time operating it, and they want to find administrative help and de-risk themselves of asset that they have.

(17:54):

So when we're having conversations with those folks, they are telling us, "Hey, I'm not that interested in Holdco. I've talked to my buddy. They got completely wiped out." So in which case, we tend to gravitate or focus on groups that have joint venture models. Now, the upside on a joint venture tranche of equity is lower, but if you're getting distributions all along the way over a two, three year, four year period, at least you can say it has economic value along the way versus Holdco where you do your transaction, you roll 30% of the proceeds over, and that might turn out to be $0 3 years from now.

(18:31):

Well, if a business goes under or gets taken over by its lender and you'd had joint venture along the way, you could at least look back and say, "Well, I've received over $2 million worth of distributions in the last 3 years, and that makes me feel a whole lot better about that decision." So as we plan out a worst case scenario for every single deal that we do as we're in market with our clients, they're generally looking for a higher floor than they are a higher ceiling. So our job is to get them in a worst case scenario, this deal is going to put you here. In a best case scenario, it's going to put you X above that. Whereby if you go with option B, your floor might be a little lower, but your ceiling might be a little higher. And that's really what we're trying to manage with our clients is finding they're really more concerned about establishing the highest floor than they are the highest ceiling these days.

Geoff Cockrell (19:23):

So Ryan, last question. We're partway into 2025. 2024 was choppy. 2025 was promising to be active and it's been moderately active, still somewhat choppy. From where you sit, what do you think the second half of 2025 is going to look like from a deal activity and what will be some of the drivers of that?

Ryan Mingus (19:45):

Yeah, we're really disappointed with how 2025 has started out. I think following the election, knowing what the White House looked like, knowing what Congress looked like, we thought it was going to be very business-centric and with a couple interest rate drops early in 2025 and a couple at the end of '24, we felt really, really good. Going into 2025, going back to Q4 of last year, we've seen some great news, couple of recapitalization events in the dental space, some very, very large, getting groups like BlackRock into the fold and getting their second and third dental investment, that's a good signal. Some of these really high quality household names in private equity that want to park money here. We know of two that are very, very close to getting done, ideally the second quarter of this year. So it's much better than '24. It's not as good of a year so far as what we had hoped.

(20:38):

That being said, if these two recaps come in where they're pegged to come in at, I think that that'll be really great wind in the sails for the dental world. I will say of all the businesses we've been looking at in the dermatology and GI and behavioral health space, those businesses are growing. So I think that there's going to be a much greater appetite from the buy side in those sectors than there is in dental. We were hoping to see a lot more people come back to dental and they just haven't yet, because I think the operational headwinds are still looming out there with inflationary environments still could be impacted by these tariffs. And if interest rates don't drop at the rate that we thought that they would, then buyers might not be as interested in going. But all that being said, we feel not as good about '25 as we did in Q4 of last year, but we also know that we are on a much better trajectory this year than we were last year, and that's taking it on an industry by industry basis when we're talking with clients.

Geoff Cockrell (21:31):

I think we will wrap it there. This has been a ton of fun. Ryan, Connor, thank you so much for joining. This has been a great discussion.

Ryan Mingus (21:38):

Thanks for having us, Geoff. Appreciate it.

Voice Over (21:43):

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@mcguirewoods.com. We look forward to hearing from you. This series was recorded and is being made available by McGuireWoods for informational purposes only. By accessing this series, you acknowledge that McGuireWoods makes no warranty, guarantee or representation as to the accuracy or sufficiency of the information featured in this installment. The views, information, or opinions expressed are solely those of the individuals involved and do not necessarily reflect those of McGuireWoods. This series should not be used as a substitute for competent legal advice from a licensed professional attorney in your state and should not be construed as an offer to make or consider any investment or course of action.