



Episode 123: New Exit Opportunities in Provider Services M&A, With Michael Kroin

Episode Summary

From his perspective as CEO and managing partner at Physician Growth Partners, [Michael Kroin](#) sees an “interesting time” where different types of buyers are getting into the provider services sector at the same time that payors are aggressively pursuing independent practices.

“You see payors start to have interest in these private equity-backed groups as well or continue to have interest. So, that provides a number of exit opportunities for these private equity-backed groups that they historically haven't evaluated,” he explained to host [Geoff Cockrell](#).

Tune in to hear Michael discuss how strategic and financial buyers now coexist in a specialty-specific landscape, how M&A activity is reopening downstream after years of balance sheet constraints and why geography matters due to state-level restrictions on the corporate practice of medicine.

Transcript

Voice over ([00:01](#)):

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, a 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. Today, I'm joined by Michael Kroin, CEO and managing partner at Physician Growth Partners. I had the privilege of working with Michael and his team on a host of transactions across the years. We're going to have an interesting discussion on the

evolution and trends within provider services deals. But Michael, if you could kind of introduce yourself and Physician Growth Partners and then we'll jump into a discussion.

Michael Kroin (00:56):

Yeah, no, no problem. And I appreciate you having me on your podcast here. Got Michael Kroin here. I'm the CEO and Managing Partner of Physician Growth Partners. We were founded in 2017 with the focus on representing healthcare service organizations or independent healthcare service organization in transaction with private equity and spent most of the time within Physician Growth Partners working on provider services deals. At the same time, we've done, at this point, close to 70 transactions representing independent groups to private equity, two strategic groups, and at this point to even some other strategic parties. And I'm happy to be here and ultimately give you a sense of what we're seeing in the market.

Geoff Cockrell (01:41):

Michael, some of the headwinds in the PPM arena still persist with labor pressures, balance sheet issues, questions on some of the models, but there's also kind of tailwinds beginning to emerge. One of them being that a lot of these platforms have been in the hands of financial sponsors for six, seven, eight or more years. And that's going to put pressure to bridge the gap between bid and ask on valuations. Where would you describe the current market for provider services transactions in particular doc-led ones?

Michael Kroin (02:21):

Yeah, it's actually interesting that you say that because I do see many groups that were, call it, started their platform in 2017, 2018, 2019, kind of come to an inflection point where they are at the end of their holding period. And being at the end of the holding period, there are decisions that do need to be made in terms of a potential recapitalization for the fund. But I guess over the last, call it 12 to 24 months in terms of activity, we actually have started to see private equity groups, depending on the specialty, ultimately start achieving their second sale or third sale, et cetera, call it the second bite or third bite of the apple. It's actually a very interesting time because historically we've seen private equity back groups go upstream from a perspective of getting recapitalizing by a larger fund. But at this point in time, we are starting to see different types of buyers come in that are interested in these platforms, including distributors like Cardinal Health, McKesson and Cencora.

(03:39):

They've all started getting into the provider services sector and had interest in eyecare, oncology, urology, gastroenterology. We also have word that Cardinal Health is also starting to have some interest in rheumatology as well, et cetera. You also see payors like Optum continue to aggressively pursue independent practices as well. And then at the same time, Optum has gone down and acquiring private equity back groups like they did with the Ortho platform in Ohio, and then there was a gastro platform in the East Coast that they also ended up bringing under their umbrella. So you see

payors start to have interest in these private equity-backed groups as well or continue to have interest. So that provides a number of, call it, exit opportunities for these private equity-backed groups that they historically haven't evaluated. And I think from the lens of these strategic parties or these payors, they are providing a different lens on how they're actually seeking to make investment in these groups from a perspective of their rationale on growth, if that makes sense.

Geoff Cockrell (04:54):

Totally. And has the group of strategic buyers of different stripes that you described, to what extent have they completely replaced financial buyers on the higher end or is it still a mix? Because one of the questions we'll come back to is once that transaction is completed, a financial buyer definitely going to have some sort of specific growth trajectory that they'd like to see with the asset they bought. A strategic buyer, maybe, maybe not. So first question is, to what extent have these strategic buyers largely displaced the financial buyers or is it now just a mixture of both?

Michael Kroin (05:35):

I think it's a mixture of both, but I would almost say it's dependent on the specialty. And depending on the specialty, we'll determine if you have distributors or other type of strategics have an interest in the specific specialty. So for instance, like urology, we do see that for the most part, you do see these strategics kind of take over the consolidation. However, in dermatology, you're continuing to see more people, groups either going upstream with private equity recapitalization, or you also see scenarios where you have mergers happening. In eye care, you kind of have both. You have McKesson and Cencora, both invested in the provider services sector, but very much you have groups like Eye South Eye Care Partners, et cetera, that are very much in the mix in these processes. So I would say it's specialty specific depending on the specialty, you will have strategic interest versus other private equity backed groups that are interested in the opportunity to pursue a result that works for what their strategic goals are under that acquisition.

Geoff Cockrell (06:54):

How are you seeing those transactions kind of ripple downstream? A lot of the middle market dynamics of transactions got very much kind of strained and slowed down as the upstream activity kind of slowed down, meaning for a long time, the consolidation maneuver was you consolidate to have a little bit bigger platform and then you sell that upstream to a bigger private equity fund who does the same and does the same. But when the high end gets stalled, it stalled the stuff below. And some of that stall was on account of kind of balance sheet problems upstream where some of these bigger platforms had kind of tapped out available debt, nobody in the existing equity ownership willing to fund additional acquisitions, and so acquisitions kind of stopped. As the market opens up for these, at least a portion of the market that is kind of financial sponsor to financial sponsor, that next financial sponsor is going to have some sort of growth strategy that's likely going to involve some M&A activity.

(07:57):

Are you seeing that start to open up the downstream part of the provider services market from an M&A perspective?

Michael Kroin (08:05):

Yeah, for the most part, yes. I mean, if you think about the timeline in terms of how everything kind of transpired since COVID, you obviously had a stall in 2020, and then in 21, 22, you definitely had rates extremely low, which ultimately put folks in a position of being quite aggressive in their acquisition strategy. And then when rates started biking up throughout end of 23 through 24, it put a position of pause for many of the groups to really focus in on their own balance sheet, as you said. And that is to the tune of focusing on operational efficiencies, really understanding what they ultimately bought and spent time on integrating and aligning what they bought before they would pursue additional acquisitions.

(09:05):

I think you fast-forward to the timeline now, you do still have scenarios where the private equity group is at the end of their timeline in terms of that investment within that specific sector where they're not willing to fork over another equity check to go after the bigger acquisitions, but they're still willing to focus on perhaps smaller opportunities that they can take on with their own cashflow or current existing debt vehicle.

(09:39):

But we're also seeing now is now that the activity is opening up where you see strategics get involved, you also see that second bite of the Apple happen across different specialties, et cetera, we do see M&A opening up, but I would say that what we're seeing from the buyer universe, whether it's a strategic or a newer private equity group, is they're being quite selective in what they're pursuing. And that is something that we have to evolve around as an organization, is really understanding what the buyers view as attractive versus not attractive to ultimately position our clients appropriately in the event of a liquidity event.

Geoff Cockrell (10:31):

Yeah. And I'm having the same conversation that I think you're having with physician-led practices that might be a seller that I'm having that conversation with private equity funds that are looking at maybe kind of reentering some of that market they'd stood on the sidelines for a bit. And when they look at provider services market, given the rise of strategics as an increasing portion of the ultimate buyer market, they're looking at the downstream market and trying to identify the characteristics of a provider services business that make it attractive to a strategic. And those are different than what people were doing before. Certainly kind of best in class management teams, all those things are still important, but the conversations I'm having both with those strategic buyers and also with private

equity funds and just kind of watching what I'm seeing in the market is I'm seeing people start to really focus in on certain characteristics.

(11:31):

For example, a strategic buyer is probably going to be more interested in geographic continuity versus say a business that has operations in one part of the country and then operations in other far flung parts of the country. Both of them doing well, but they're not connected because that might impact their ability to leverage into their kind of rate structure or bring it into their rate structure, characteristics like that, acquisition strategies, growth through acquisition strategies that are on a smaller scale is often a winning idea from a strategic, meaning a platform that has been growing through M&A, but in a whole bunch of small bytes is easier for them to wrap their head around a continuation of that strategy on a go forward basis in their hands. So there's some different characteristics that I think the strategics are looking for. What would you kind of add or critique of that list of notable characteristics?

Michael Kroin (12:34):

Yeah, both from a strategic and private equity side, I think the type of practice that the group is in terms of what they're actually doing from a service perspective, I think that's very important. Understanding from a strategic side, I think one thing that they look at is what is their drug spend as well, and understanding if that type of practice fits under their umbrella based on what their motives are from a transaction perspective.

(13:05):

I think what we've also noticed that is actually very top of mind for anything that we're doing is the additional restrictions that are being applied at the state level from a corporate practice of medicine perspective, like with the new legislation that recently was passed in Oregon, as well as in California, there's a lot of discussions around what state is next and how is that going to evolve and what is that going to do from both a strategic perspective and a private equity perspective on a level of interest to chase large assets that are doing quite well that kind of check all the boxes, but they're in a more restrictive state when it comes to corporate practice of medicine. So that is one thing that's been top of mind for us is ultimately the geographic location of some of these assets that we're ultimately representing.

Geoff Cockrell (14:03):

Another characteristic that I have conversations with folks about is how they're thinking about provider alignment as it relates to if the eventual buyer is a large strategic that is perhaps not going to be on a trajectory of flipping or recapitalizing every three or four years, but it's going to be a more of a steady state platform going forward. How has the target been thinking about creating provider alignment with tools that won't evaporate upon that sale? There's a lot of thinking around that. And I've set up kind of provider alignment structures that are kind of synthetic equity, meaning the profit-based kind of

current distributions through a compensation apparatus, but that looks sort of like what a sub MSO or something might look like, but is a current cash flow and is designed to be permanent and not something that would ebb away in a transaction. So a lot of thought around in this category of positioning yourself, put in place mechanics within the platform itself that are going to be attractive to a strategic buyer.

Michael Kroin (15:13):

Yeah. When I think about a level of alignment, I think the groups that we feel are doing it in a way that will ultimately succeed in the long run is they're looking at it from three different lenses is how do we get the provider group aligned from an individual contributorship perspective, and that is based on their perhaps productivity, so like a percentage of collections or something along those lines. At the same time, how do we also create alignment at the local practice level where they can get a piece of the pie from a profits interest perspective or a profit share perspective where they get a piece of the profit. So not only are they cognizant of what they're bringing from a revenue perspective, they're also going to be cognizant of how they spend their money as well at the local practice. And then at the same time, could you create a level of alignment at the, let's call it MSO level as well, so that they can have participate in future liquidity events related to the second, third sale, et cetera.

(16:26):

But I think the groups that are kind of what we're seeing today, and I do think that this is kind of called private equity 3.0 that we're seeing is figuring out ways to create alignment, not just on an individual level, but at the practice level as well, where if the pie grows at the local level based on their contribution, their overall perhaps compensation will grow and that's where you get income repair, et cetera. The key question is when you have a group of three, four shareholders, but you have up to 20 providers in a practice, is how do you create that alignment with not just the shareholders, but also with the associates as well eventually so that you create stickiness from a broader perspective, not just at a shareholder level perspective.

Geoff Cockrell (17:18):

I'm finding covered the entire spectrum from production-based comp to profit distribution-based comp at the local practice level all the way topco equity. I'm finding a lot of the discussions are thinking if they should be leaning less heavily into topco equity as an alignment tool for a number of reasons. One is the landscape has certainly got a number of platforms where that dream got zeroed out when there was a recap that was basically just sending the MSO to the lender and kind of rollover equity had been wiped out entirely and the providers themselves have become more focused on year by year aggregate consideration versus the secondary sale event.

(18:07):

And that also, if you can thread that needle and migrate more of the alignment mechanism into a more perpetual structure, like what you were saying, the middle part of that spectrum, where you've

got current compensation that is key to the performance of a local practice, that can become a durable idea that will also be attractive to a strategic because part of their concern, if it's heavily weighted in rollover as the alignment mechanism, is that they may not be able to deliver an additional sale later on, number one.

(18:40):

And number two, if a lot of that rollover is being cashed out in their transaction, it was an alignment feature up until the point of their sale, but it's kind of being stripped away by the transaction itself. So I see folks really trying to think about durable alignment mechanisms in this evolving market.

Michael Kroin (18:57):

Yeah, I couldn't agree more. I think the question really sits is, or the biggest focus I think from a provider perspective is two things. It's, "Hey, I just gave up a level of compensation to get this money upfront." Now, from a buyer perspective, how do you find a way to repair their income so they feel like they owe from a couple years down the road, they potentially can get to call it 70%, 80%, 60% of what they were making before so that they have this level of alignment where they're in a similar place that they were before as they are after. And at the same time, I do think that I still haven't seen groups truly figure this out is ultimately I do believe the success of these platforms beyond the First Bite or Second Bite or whatever you want to call it is going to be based on how do you create alignment with the younger physicians and how can you find a scenario where there is a provider right out of school that's currently an associate?

(20:09):

What are the mechanisms that you can ultimately figure out outside of phantom equity or profits interest that you can give them, et cetera, that you can help them buy in? But what are ways that you can ultimately create a level alignment where they can benefit at the local practice level as well? That's a key that I think groups that can figure that out where they focus on how do we solve for the next generation of providers are the groups that I think are going to have a great successful track record.

Geoff Cockrell (20:45):

And for the kind of sponsor backed platforms, the venue where I see people leaning most heavily into for the group that you're describing, like the up and coming doctors, and what are you going to do that is aligning them with you? You could obviously layer in compensatory apparatus of kind of profit sharing or other things, but none of that is free. The one kind of accretive area that I see a lot of attention being focused on, and this doesn't apply to every specialty, but to a number of them, is if you can find ways to add some of the kind of ancillary revenue streams, usually in the form of building out an ASC, building out an imaging center, and that's part of the allure of private equity is that they bring capital to the table that can kind of open things up that would have been hard to do without that capital.

(21:36):

So a lot of, for the bigger platforms that I work with, I'm spending a lot of time on fairly intricate, often joint venture structures where you're a joint venture with a health system, for example, to establish an imaging center. And there's different ways you can set that up and those are often dictated by the market. If there's an existing kind of imaging center, you might do one sort of apparatus with the health system. If there's not one, you may be doing it on your own. You may be doing a direct joint venture where you're kind of building that center with the health system and kind of leaning into their reimbursement rates. There's a lot of ways to go about that and they can be somewhat complicated, but finding new revenue streams is one of the ways to kind of build alignment because if you can do that, you can structure those revenue streams in a way that are bringing all the relevant constituencies into those economics.

(22:30):

And for example, it might be providers being partial owners of the ASC. It might be an ASC that's parked underneath a practice and is feeding into the comp structure, but finding those additional revenue streams is the key.

Michael Kroin (22:45):

Yeah, I agree. And I almost look at the scenarios on what you see from a historical perspective where you had groups with surgery center consolidation where you'd have partnership between 51 to 60%, and then the rest would be left at the local level, and there's level of distribution there into the hands of the doctors that are owners in that surgery center. I think figuring out a model that ultimately creates an opportunity for future providers that are similar like that into the practice side, I think is key that ultimately creates a buy-in, buy-out structure as well that isn't too aggressive where it's not realistic for someone to pay a person out a resident or three years out of school, pay 4 or 5 million dollars to buy in. And figuring out ways that allows them to participate with a minimal investment to create that level of alignment.

(23:51):

I almost go back to the surgery center models when you have the surgery center consolidation going on with and fit them utilizing that type of methodology as a starting point into the PPM sector on some of these kind of JV structures, I think is important as well to take into consideration. So completely agree with you in everything you're saying there.

Geoff Cockrell (24:13):

Michael, we could probably go on for quite a bit, but I think we're about out of time. So I think we will end it there. I'm sure we'll be working together either on the same side of the table or the opposite side of the table on a number of things in the coming year, but I really appreciate you joining me this morning. It's been a ton of fun.

Michael Kroin (24:31):

Awesome. Look, I appreciate you having me and look forward to continuing to work together against each other.

Voice over (24:40):

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 McGuire Woods. 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.