McGuireWoods

Episode 130: Oncology and Retina: Follow the Drug Spend, With Jeanne Proia

Episode Summary

Oncology commands roughly 40% of the national drug spend. Retina is close behind. “If you follow the drug spend, you’ll find that the distributors are really building an ecosystem around it,” says Jeanne Proia, managing director at Cross Keys Capital and president of its healthcare services group.

In this conversation with McGuireWoods partner and host Geoff Cockrell, Jeanne unpacks the market. Unlike traditional PE deals, she says, these transactions leave physicians holding their own equity inside a long-term MSO relationship, trading the second bite at the apple for cash upfront and taking the risk off.

As she explains: “They’re able to bring a lot more synergies just because they’re getting to be bigger and bigger, and they can use that money to support all the synergies, whether it’s clinical trials, recruiting or RCM.”

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 (00:18):
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.

(00:32):
Today I'm joined by Jeanne Proia. Jeanne's an MD at Cross Keys Capital, which is an investment bank that focuses heavily on healthcare, different kind of venues within healthcare. And then within that further, she's the president of their healthcare services group.

(00:45):
Jeanne, if you could give a little introduction of yourself and Cross Keys, that would be super helpful and then we'll jump into some discussion.

Jeanne Proia (00:52):
Absolutely. So as you've said, Cross Keys is a middle market investment banking firm, and I run our healthcare group. The vast majority of that is physician practice management transactions, but we also do some revenue cycle management, payers, things like that. We've closed over 200 transactions with physicians, covered more than 30 specialties. And I didn't come up through the traditional investment banker route, I actually was working as a buyer for a public company and met Cross Keys, and I just really was drawn to how white glove approach they are with physicians which I think is extremely important, so joined them about 10 years ago. And currently, we're doing work in a lot of different specialties, but really heavily in oncology and retina.

Geoff Cockrell (01:37):
So you mentioned that you've got done deals in 30 different subsectors within provider services, but are focusing a lot on oncology and retina. Before we focus on oncology and retina, what has been the driver of doing less than some of the others?

Jeanne Proia (01:54):
There's been a little tightening, I think, on multiples. As well as on the timing of transactions. I think the buyers are getting more sophisticated in their due diligence, they're less willing to do some of the earn-out payments, but there's still plenty of activity happening. And I think when times are a little bit harder, like during COVID and now during all the political unrest we have going on, I think it actually brings some of these smaller groups that need a home, or need a support system from the PE backer or a strategic backer, it brings them to light. So I do think we're going to see activity pick up this year, in all specialties, for the most part.

Geoff Cockrell (02:31):
One of the drivers of, some of the headwinds in provider services from where I sit, has been kind of difficulty in conceiving of who can be a buyer of something that is already big. You can run out of room for there to be always a bigger private equity fund, there's a lot of different ideas of how that part of the market can evolve. Everyone gets bought by Optum, but that's an unlikely scenario. But in

oncology and retina in particular, a different class of buyers has emerged. Can you talk some about how those new buyers have emerged, and what those deals sort of look like?

Jeanne Proia (03:13):
Absolutely. So if you follow the drug spend, you'll find that the distributors are really building a ecosystem around that spend. They are very focused on community-based cancer care, but being able to generate the drugs and keep all of the margin down to the provider is really an advantage for them. So the drug spend is heavily weighted to oncology, it's about 40% of the national drug spend, and retina's the second. But there's a lot of other specialties too, that maybe they're in the five to 10% of the drug spend, but still could be a benefit. So I do think you're going to see these companies, like Syncora and McKesson and Mayer platforms, expand beyond oncology and beyond retina into some of these referral sources as well as a lot of these specialties that use drugs. Like you just saw the Solaris transaction as well as the Gastro Alliance transaction, that both went to Cardinal.

Geoff Cockrell (04:07):
So the notion of vertical integration of those drug manufacturers can be a driver. In the hands of those large buyers, it would seem to introduce some different sorts of complications of what that deal looks like. When you think of the provider in particular, who's usually an owner of rollover equity and they're kind of looking down, a typical private equity setup has got a owner selling to a private equity backed platform, and then they're looking to get a second or third bite at the apple as that equity transacts down the road. Now we're talking about kind of a terminal purchaser, by and large. How do you think through ongoing alignment of those providers to that larger platform, once you've pulled away the idea of there being future sales of equity? To the extent that you have.

Jeanne Proia (04:56):
Yeah, I think the way that they are structured in most cases, now each buyer obviously has a little different structure on how they do things. And we actually don't call them buyers because in the most cases, they are not actually buying out the equity. The physicians are keeping the equity in their practice, and it's really just an MSO relationship. But you're right, it's a long-term relationship. They're locked in for 25 to 30 years in these relationships, so there is no real second bite at the apple for most of the doctors.

(05:23):
But they are giving a lot of cash upfront, taking a lot of the risk off. And then, in general, they're able to maintain the compensation. So you don't have the big compensation cut that you have in a traditional PE, where you're taking a lot of risk. Here, they're supporting your growth, they're able to bring a lot more synergies just because they're getting to be bigger and bigger, and they can use that money to support all the synergies. Whether it's clinical trials, recruiting, RCM. Obviously drug inventory optimization is crucial.

(05:53):
So it's really just a different mentality, and I think the doctors really like it, because they do get to maintain the equity. And typically, they are just given a pool of money and they can spend it how they want, clinically. And so they still feel like they have more control than a PE backed entity.

(06:09):
And finally, it does still leave opportunity for them to attract physician track physicians because they still can get a piece of equity. Now, what that equity is worth until the end of the term of that agreement is not probably as much as some of these PEs, but at the end of that term, they are going to have an opportunity to sign up for another term, and maybe have a cashflow event then.

Geoff Cockrell (06:32):
Whenever you're looking at transactions that involve either mergers of large companies, or large scale vertical integration, it poses antitrust questions of creating non-market competitive dynamics. Selling into that environment, how big of a concern is that, and what have you seen? How have you seen strategics navigating those concerns?

Jeanne Proia (06:57):
So we really haven't seen much push on that. I mean, it's a great question, and I think it's a valid concern in a lot of ways. But there's still a lot of competition between the big companies, as well as hospitals trying to bring oncology groups in, because of 340B money. So I think there's still quite a bit of true competition out there, but it'll remain to be seen in the future years, if something pops up politically.

Geoff Cockrell (07:20):
Does the transactions in the retina subspecialty of ophthalmology, do they look the same? And a lot of ophthalmology practices tend to be, or are often not, pure play specialists in terms of retina. How do you think about mixed platforms that you have some specialization, but then also some general ophthalmology in that context?

Jeanne Proia (07:43):
So I do think that distributors are going to start getting into that space. I think they're going to want some portion of retina, but we know of a few transactions that are currently underway that would end up with a true ophthalmology group with just a few retina physicians underneath those drug distributors. So I do think that'll happen.

Geoff Cockrell (08:03):
You mentioned that oncology and retina drugs are some of the larger spends. Can you talk through some of the other sectors where this idea would seem, maybe at a little bit smaller scale, be a replicable idea? Because I know that in a lot of subsectors, finding ways to expand the universe of

who could be an acquirer of a larger MSO is a very kind of loaded topic. You mentioned GI, but there could be others. How do you think about that, as you're looking upstream?

Jeanne Proia (08:36):
So the third-biggest part is rheumatology, and that really hasn't done a lot of consolidation so far. So I think there's pretty good opportunity there. I think also urology, it's not one of the bigger spenders. It's probably one to 2% of the drug spend, but it's a great referral source for the oncology network, so I think it's going to go beyond just where can they get the best drug margin, but how can they help guide the patient through a truly interactive oncology progress, with different specialties and things connected?

Geoff Cockrell (09:08):
Exploring more broadly the idea of vertical integration, you've talked some about it through the lens of distribution of drugs. Are there other avenues where vertical integration could have a similar dynamic with orthopedic practices? What other sorts of distributor model buyers do you think are going to materialize?

Jeanne Proia (09:30):
That's a really interesting question, and I don't know that I've spent a lot of time thinking about that, but I will now. I agree that there's going to be some equipment companies that could take that on. There's some large public companies that are consolidators of other specialties, but they're focusing a lot on AI or health tech, so they're going to be able to consolidate a variety of different specialties.

Geoff Cockrell (09:52):
Going back to oncology and retina, this kind of consolidation effect, what inning do you think that is in? Is it still early? These sorts of deals were unheard of three years ago, but it's also a narrower market of things at that scale and you could run through the consolidatable platforms pretty quickly. What inning is that in for both oncology and retina?

Jeanne Proia (10:17):
I think that it's a very short set of innings, and we are probably in the middle to the end of it, just because of the lack of opportunities there. There's fewer practices of any size to join. But transactions are so compelling to the doctors. Again, they get to keep their equity, they get cash upfront, they get typically either the same compensation or better compensation going forward. They get the support of these big companies that have... US oncology has 2,000 physicians, so they can go out and spend money on systems, and clinical trials, and all of these things that would be virtually impossible for a small practice to provide. So I do think there's still some runway, but it's going to be a few practices a year, because that's really all that are out there in oncology. Retina maybe a little more, but again, to find a retina only practice that's three or more physicians, there's not that many left of them.

Geoff Cockrell (11:11):
And to the extent that all consolidation ideas tend to run out of steam eventually, that lends itself to a little bit of musical chairs in that process. Which side of that calculus do you think runs out first? Meaning, you run out of large distributors of oncology drugs that can be a buyer, or do you run out of larger practices that can be a seller? Which side does the musical chairs land on?

Jeanne Proia (11:36):
I think you probably run out of practices first, because there's some practices that just are never going to want to have some kind of partner, and that's completely acceptable. And you're also going to have some that are going to join the hospital as well, there's quite a bit of urgency to get the hospitals to have the oncology groups, because of the 340B money. So I think that those practices are just going to get fewer and fewer in between, that are available for consolidation.

Geoff Cockrell (12:02):
In kind of the reverse of what was happening in a number of other sectors, where the challenges of finding buyers eventually rippled downstream to make the smaller consolidation deals harder to pull off. For understandable reasons, is that happening in reverse in some of these areas, where the opportunity of new buyers has emerged? Meaning, has the downstream market of smaller consolidators been opened up by the possibility of there being more terminal buyers on the other end of that chain?

Jeanne Proia (12:34):
I think it's starting to open up. I think people are just starting to identify what's happening and see that, but these drug distributors are also willing to buy things that are connected, like a gamma knife company, or a small urogynecology group that before wouldn't have been easily consolidated into something, but it may only be one or two doctors and they may be fine with that. So I think you're going to see over time, when the larger groups get limited even more, you're going to see these smaller groups be able to tuck in more easily.

Geoff Cockrell (13:04):
Maybe shifting back away from oncology and retina work, I know that you guys have done work in a lot of other areas. One of the areas where I have a long background with Cross Keys in particular is in the anesthesia arena. There was a time when that was a white-hot consolidation area, and then it stopped being. Is that coming back, and what are some of the drivers that might be bringing that back?

Jeanne Proia (13:28):
Yeah, I find that really interesting, that anesthesia is actually making a comeback. I previously, when I said I worked at a public company, it was MEDNAX and we were consolidating anesthesia groups, and that their anesthesia group has since been sold to NAPA. So there's been a lot of activity and not

all positive. There's been some negative connotations with some of the companies that consolidated anesthesia. That being said, I have been reached out to by more than a dozen PE firms that are now interested in anesthesia again. And I think it's just the hospital-based transactions can be really, really great, and they can be easier to consolidate. And the physicians typically are a little more willing to do a deal, because they don't have as much control over their schedules and things anyway, because they're in the hospital and the hospital's dictating their hours and things like that.

(14:14):
So I think it's a really solid thing to consolidate, but it is interesting that it's coming back around because there have been some concerns over it.

Geoff Cockrell (14:21):
Yeah, it would seem that there's room for quality execution. Some of the original much larger consolidators, their reputations with providers that they were difficult to work with, or some other consolidators got crosswise from an antitrust perspective of leveraging too much power on local hospitals. But it would seem, to your point, that that leaves open a lot of other models that could still be successful. How much activity are you starting to see come around in anesthesia? Because we're starting to hear flickers of it as well.

Jeanne Proia (14:55):
Yeah, I haven't seen any significant transactions be completed yet, but I do know there's a couple of things in the works, and I do think by the end of the year, we'll see a few things happening. I don't know how big it'll be, I just find it extremely interesting that these PE firms are willing to start a platform in anesthesia again.

Geoff Cockrell (15:12):
One of the challenges over the past couple of years, kind of across all sectors in provider services, has been a lack of arriving at pricing. So sellers had a particular view in mind of EBITDA multiples, or EBITDA add backs, or everything that goes into bid-ask calculations from a seller perspective. Those got very divergent from what in particular private equity buyers could tolerate from a purchase price, especially an environment with increasing cost of labor pressures, increasing cost of capital. All of those were pushing multiples down, and that bid-ask differential that just kind of froze parts of the market. You're closer to counseling around sellers, how is the bid-ask conversation with sellers going at this point?

Jeanne Proia (15:58):
So I think there's still a lot of sellers who heard from their friend down the street they did a deal at 30X, which is unrealistic and not true. But the same group can have a seller who says, "I sold something at a 20X," and the buyer says, "I bought it at a 10X." So you have to be very careful with what people really feel like the transaction was done within. But I think the sellers are more

knowledgeable, I think the buyers are definitely more knowledgeable, and together that makes a better conversation. But these outsized multiples are really, other than maybe in a very few specific cases, are really just kind of gone. But I think the physicians can understand that, in general, with having seen what's happened in the last couple of years.

Geoff Cockrell (16:40):
And I've found the advice from bankers like yourself getting a little bit more reasonable, and kind of modulating seller's expectations of being able to transact on some theoretical run rate EBITDA looking forward, or adding in expectations on de novos that have been started. Some of those expectations from sellers have gotten much more reasonable, and makes it easier to navigate.

Jeanne Proia (17:04):
Yeah, absolutely. 100% agree. We try to be very straightforward with our physicians, and very honest with them as to what they're going to be offered on. And I do think earn-outs have also become more acceptable in certain ways, and people are willing to put a little more risk in the future. And the physicians can also get behind that, because if they truly believe it's coming, they can support deferred payments.

Geoff Cockrell (17:25):
When you're talking to, let's say, a little bit smaller groups that are thinking they want to be acquired, what are some of the preparatory things for getting your business in line that you would recommend people do? And a couple of ideas come to mind. When I'm talking with buyers, or if we're showing a deal that say an independent sponsor has, potential capital providers. One of the refrains that I hear often is if it's a multi-site type of business, you'd better have more than one site. You had better have your accounting in line. Just some things that you could think of doing in preparation. What would be on your list?

Jeanne Proia (18:04):
So I think the first one is, make sure that you have the right structure in your entity. We are seeing a lot of practices that are C Corps, and tax-wise, that's not a beneficial structure to do a transaction. So I would definitely consult a tax accountant.

(18:19):
Also, getting your books in order, that is one of the biggest pieces, because we see more and more quality of earnings documents being completed during a transaction. And so if you can kind of get ahead of the game, and be prepared for that, I think it's beneficial.

(18:33):
Also, just locking in your associates or your nurse practitioners, making sure that you're as fully staffed as you can be, or have a plan to be fully staffed. Any growth, you're very unlikely to get any

benefit from a buyer. If you say, "I'm planning to do this," or, "I think I'm going to do that." But if you have a true LOI, or a term sheet saying you're going to open another location or you're going to start a new service, those things can also be extremely beneficial.

Geoff Cockrell (19:01):
While EBITDA can be a slippery metric, what are the bottom ranges that you need to be, to be considered for an acquisition either by a strategic, or the minimal size to be considered a small platform?

Jeanne Proia (19:14):
I think platform-wise, it's typically maybe three to five million on the low end, just because there's not a ton of large opportunities anymore and in almost any specialty. Or if they are, they're probably independent for a reason. So I do think it's pretty small base for a platform, potentially. It's more about, "How have you grown? Have you done acquisitions in the past? Have you done de novo? Do you have a leader who's excited about growth and wants to stick around? Or do you have a leader who's in his 70s, and is looking for an exit strategy?" That's probably more important than size, in a lot of ways. But I also think there's a lot of transactions that are getting done with a million, they're not big transactions, they're not showy transactions, but a lot of those tuck-ins are happening at much less EBITDA.

Geoff Cockrell (19:59):
Jeanne, I think we could talk about this sector for quite a bit, but I think we've run out of time. I really appreciate you joining, certainly think super highly of you and your brethren at Cross Keys, and thanks again for joining.

Jeanne Proia (20:11):
Well, thank you very much. I've had a great time.

Voice Over (20:14):
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.

(20:27):
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