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VALUE CREATION IN HEALTHCARE

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VALUE CREATION IN HEALTHCARE

On April 21st, Sapling Financial Consultants presented the first webinar in ACG Toronto's new Value Creation series, for which Sapling is the lead sponsor. In this webinar, the panel discussed the Canadian healthcare landscape, focusing on the roll-up or consolidation strategy. To kick off the discussion, panelists provided an overview of Canada's publicly funded healthcare system, which is overseen by both the federal and provincial governments. The federal government legislated the Canada Health Act to facilitate the delivery of services to various payers. As provincial governments are large payers, this creates both opportunities and risks for value creation. When considering the roll-up strategy, investors should be aware that each province has its own health plan and regulations, distinct from other provinces and territories. For instance, health professionals across Canada are governed by different provincial colleges and associations. In this webinar, panelists discussed the process of identifying targets, followed by insurance and IT due diligence, the 100-day plan, value creation from a financial perspective, and the impact of COVID on healthcare. A detailed writeup by section is provided below.

Identifying Targets

A critical part of the roll-up strategy is the process of identifying targets. Each firm conducts this process differently, according to its investment philosophy. Short-term investors have a much shorter investment horizon than long-term investors, and strategic investors are more hands-on in the value-add process than their financial counterparts. Investors can use three buckets of criteria to evaluate targets: relative attractiveness, relative adjacency or familiarity, and actionality or fragmentation. Actionality is related to fragmentation as players in fragmented markets are poised for growth through M&A, making incumbents more open to the idea of consolidation. You can assess an industry's stage of maturation or degree of consolidation by comparing different healthcare verticals on the consolidation curve. Roll-up entities also need to understand the business model of potential targets and whether their services are recurring. To fully understand a business model, investors need to focus on the target's marketing generation. Following these steps, investors can map and benchmark various sectors. An example of healthcare consolidation is the dental industry. The dental industry was one of the first in the US to begin consolidating due to its recurring model; however, parts of the industry remain relatively fragmented. Dental roll-ups tend to look for profitable businesses on which they can improve rather than fixer-uppers.

Insurance and IT Due Diligence

Another important step in the roll-up strategy for investors is conducting insurance and IT due diligence. Buyers need to understand different areas of risk exposure and how much a transaction may add to their total cost of insurance. There are a few coverage exclusions for medical clinics. Firstly, while medical professionals are insured through their associations, nurses are only covered when unemployed. When nurses are employed, their employer is responsible for providing

coverage. A gap also exists in the coverage provided by the Canadian Medical Protective Association (CMPA). The CMPA covers doctors and providers of medical services but not medical directors and non-clinical workers, so the latter group requires additional errors and omissions insurance. Finally, buyers need to conduct intensive IT due diligence, as cyber issues will cause many problems down the line. Any IT infrastructure investments that need to be made should be identified within the first 30 to 45 days.

100-Day Plan

The panel recommended creating a 100-day plan with selling partners, which should outline critical elements of value creation, such as team building, insurance, digital marketing, and financial reporting. The goal of the 100-day plan is to set a strategic direction for the company, identifying areas of the business that can be improved upon and devising a detailed action plan. Many partnerships include a living integration plan with doctors or dentists. There can be several thousand employees across portfolio companies. A top priority is getting everyone on one payroll and benefits platform. Having all payroll activities on one platform allows for greater accessibility, time savings, and better management. Another important aspect of the roll-up process is cultural integration between practices. Management should meet weekly with teams at clinics to support a smooth integration and keep employee morale high. An essential part of this integration is standardizing best practices across clinics and verticals.

Audience Polling

According to a poll conducted during the webinar, the audience believed that the most important piece of value creation was sales, winning by a wide margin with 58% of the votes, followed by finance at 13%. While sales is a critical function in value creation, it is often the least mature in purchased organizations. For instance, incumbents in the dental industry are not focused on coming up with new approaches to attract customers through digital marketing. Focusing on sales may also be a “tough sell” in Canada’s healthcare landscape, as it is difficult to get Canadian patients to pay for healthcare, since they are used to it being “free”. As healthcare is a heavily regulated sector, there are also many limitations on advertising and promotion.

Value Creation in Finance

CFOs often have to wear both data and IT hats in their roles. Data-driven insights are key to the value creation process for healthcare roll-ups. One way to drive insights is through dashboards. Electronic medical records capture a high volume of data but are seldom used outside direct patient work. Dashboards allow practice managers to visualize this data and keep track of their performance. Power BI dashboards are popular with clinicians for their ease of use and attractive interface. Ultimately, the goal is to summarize and simplify data for decision-making. Many

healthcare providers also use practice management systems. However, these systems do not provide information for meaningful decision-making. There are currently more than 20 different practice management software systems in the dental industry, for instance, with no standardization.

COVID Impact

COVID has brought many changes to the healthcare industry, from an insurance perspective to broader industry trends. Because healthcare providers have been at the frontline of COVID, many have lost capacity for non-COVID treatments, and government restrictions have impeded the operation of lucrative procedures. For these unanticipated issues, insurers may have to pay an additional \$10k to \$50k in business interruption claims. However, insurers are trying to exclude all payouts related to COVID by refuting liability.

Another key industry trend that has emerged during COVID is telehealth. During this time, telehealth has become a necessity as many portfolio companies have not been able to provide in-person meetings. More than ever before, the pandemic has underscored the importance of efficiencies in care and the accuracy of online delivery. These trends will likely set the foundation for the future of healthcare.

What's Next?

As we have seen, the roll-up strategy is a growing phenomenon in the healthcare industry. For this strategy to be successful in creating value, some critical steps that investors should follow include properly identifying targets, conducting insurance and IT due diligence, creating a 100-day plan, and driving insights through data. As the healthcare landscape continues to shift, what do you envision as the future of the healthcare market? Will the industry continue to follow a trend of consolidation, or is a reversal on the horizon?