Practice Management

Investment Trends in Urgent Care: A Mergers and Acquisitions Roundtable

Urgent message: Urgent care is a highly fragmented industry considered ripe for consolidation. A handful of high-profile deals have made 2015 the biggest year for mergers and acquisitions yet, but high valuations, oversaturated markets, changing buyer and seller expectations, and structural changes attributable to the Patient Protection and Affordable Care Act will influence urgent care deal-making in coming years.

Introduction

Mergers and acquisitions (M&A) in the U.S. urgent care industry have historically consisted of regional and national aggregators acquiring one-off and local networks of centers to attain operating scale; private equity (PE) groups seeking platforms for aggregation; and health systems acquiring urgent care centers to expand their geographic coverage, increase their brand visibility, and drive downstream revenues into their hospitals and affiliated provider networks.

Many urgent care start-ups have embarked on their entrepreneurial journeys with the idea of one day selling. Large, well-publicized deals such as the $1.1 billion acquisition of Concentra by Select Medical/Welsh, Carson, Anderson & Stowe,[1] UnitedHealthcare/Optum's acquisition of 141 MedExpress centers in 11 states,[2] and ABRY Partners' acquisition of FastMed's 87 centers in North Carolina and Arizona[3] have raised the expectations of some owners seeking an exit strategy.

The urgent care industry is rapidly changing in response to the Patient Protection and Affordable Care Act, passed in 2010, which is changing how patients pay for medical services and spurring the desire for hospitals to expand accountable care organizations (ACOs). Also driving change is the exponential growth of start-up urgent care centers in response to patient demand, lack of entry barriers, and availability of investment capital.

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In this article, a panel of M&A experts on the urgent

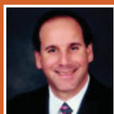
Moderator

Alan A. Ayers, MBA, MAcc, is Vice President of Corporate Development for Concentra Urgent Care, a member of the Board of Directors of the Urgent Care Association of America, and Practice Management Editor for *JUCM—The Journal of Urgent Care Medicine.*

Panelist Profiles

Jeffrey R. Gerlach is Senior Vice President of Business Development and Strategic Growth for NextCare Urgent Care, which operates 123 walk-in medical centers in 13 states.

Scott Witter is the Director of Business Development and Mergers and Acquisitions at U.S. HealthWorks, a subsidiary of Dignity Health that operates 221 occupational health-care and urgent care centers in 19 states.



Dexter Braff is President of the Braff Group, a health-care mergers and acquisition advisory firm with more than 18 years of experience.

Blayne Rush is the President of Ambulatory Alliances, LLC and is an investment banker with over 15 years of health-care experience focused on business transactions, complex negotiations, and financial analysis for over 250 health-care organizations ranging from physician groups to corporate partners and hospital health systems.

care industry provides an update on the overall marketplace for urgent care centers—from a buyer's perspective and a seller's perspective.

The Big Trends

Alan Ayers: What are the biggest trends you're seeing in urgent care investment and deal-making for 2015? How do you see these trends changing over the next 2 to 3 years?

Scott Witter: 2015 will be marked as the year of the largest transactions we may experience for some time, with MedExpress, Concentra, FastMed, and likely one or two more large operators changing ownership. Relatively high valuations driven by cheap debt and high demand from a variety of acquirers, coupled with a number of large operators who were PE-backed, meant that the end of the investment life cycle came together in a number of large acquisitions. Going forward for the next couple years, we'll likely not see such sizable deals, but we will continue to experience significant M&A, because the larger operators will continue to expand geographically. It's still a fragmented industry with many long-term positive growth drivers that will propel ongoing consolidation.

Dexter Braff: If I had to narrow this down to one significant development, it would be that deal-making is beginning to move downstream in terms of size. When private equity first entered the scene, the focus was on buying urgent care operations with 10, 20, 30, or more centers to establish platforms in targeted regions. As markets become more fully developed, and hence more difficult settings for planting new start-ups, and as PE sponsors move toward the back end of their investment cycles where start-ups become less practical, acquisition activity will shift toward 1- to 3-center operators that can fill gaps in geographic coverage or add incremental revenues and profits. This will make for a far more inclusive urgent care M&A market.

Jeff Gerlach: The true urgent care deals (episodic illness and injury) are becoming harder to find. Many have incorporated primary care and family care and other ancillary services into their offering. In addition, valuation expectations of true sellers have risen. The industry has been fairly picked over by market aggregators, brokers, investment bankers, and PE, resulting in a more sophisticated seller. Also, certain markets have become incredibly saturated.

Blayne Rush: In 2014, de novo expansion slowed for some of the larger groups, which could be due to the fact that they were preparing for an exit in 2015, but it also has to do with the limited green space in the areas these groups are playing. Some of the platforms that have recently traded are ramping up de novo again, but not to the extent of years past. There is not a true national management company, and for a management company to move into a new geographic area, they want 5 centers clustered. Well, there are a lot of 1- to 3-center owners, but not as many 5-center owners, which makes moving into new markets complicated. Urgent care has been hot for a few years now, and it will continue. I do think we will see a shift at the end of 2016 or early 2017 as recent acquirers try to figure out how they will continue to grow and move into new markets. I believe consolidation will slow a little at that time, but we still have 8 to 10 more good years in the space.

The Marketplace for Buyers

Alan Ayers: What does the current marketplace for urgent care practices look like from a buyer's perspective? What is the current buyer universe, and what are buyers looking for in acquisition targets?

Jeff Gerlach: Buyers are looking for stability and growth potential. It is also important that the seller, if a physician, is looking to remain engaged at least into the foreseeable future. Stability within the provider base is also incredibly important. Other important factors are a premium location, a solid physical plant, and a lack of primary-care services within the trade area. When entering a new market, we look to acquire a business that will give us some market presence, and then look to understand the path to continued growth to achieve significant presence. Typically that's a combination of prioritizing continued acquisitions, and then developing de novo locations.

Scott Witter: From a buyer's perspective there is competitive demand for good opportunities, and the valuations of larger urgent care chains are near historic levels. However, it remains questionable whether expected returns will be delivered to recent buyers at these elevated valuation levels. Buyers will continue to come from the ranks of health systems, payors, large operators, PE, and related industry participants (e.g., Select Medical/Concentra, Fresenius/MedSpring), yet they will all be looking to fulfill their different needs. Large operators may be looking for economies of scale, geographic expansion, and opportunities for operational improvement, whereas health systems may be looking more for management and operational expertise, which they may be lacking.

Dexter Braff: A unique element of urgent care consolidation is the nature of the buyers targeting the sector. In virtually all of the other health-care service sector consolidations—skilled nursing facilities (SNFs), home health and hospice (HHA), pharmacy services, durable medical equipment, and others—the initial waves of consolidation were almost purely same-sector deals. SNFs were

buying other SNFs, HHAs were buying other HHAs, etc. But not so in urgent care. Yes, you have your same-sector buyers, but you also have outside PE investors, hospitals, insurance companies, and physician groups, each pursuing urgent care for different financial and strategic reasons. This makes for a highly competitive and dynamic market—ideal, if you're a seller.

Blayne Rush: Each buyer has their own sweet spot and list of qualifications. If a well-respected buyer passes, that is a red flag to other buyers even though it could due to an issue important to just that one buyer. It's much easier to take the time to prepare the business than to try to turn a buyer who says no into one who says yes or to change the market's perceptions. It's the seller's job to prepare the business if they want to maximize their transaction price and cash in their bank or to engage someone who will do it with them.

The Marketplace for Sellers

Alan Ayers: How does the market look from a seller's perspective? What do you see in common among owners who are looking to sell their practices?

Dexter Braff: Clearly, the urgent care M&A market is outstanding if you are a seller. Perhaps the better news, however, is that from all indications, the market has legs—that is, it has a long runway ahead. If you're in start-up mode, the window is somewhat limited, because the land grab is tempered by saturation. But it's that very dynamic which will support an extended run of selling opportunities. Because once the most desirable geography is built up, the only way to break in is via an acquisition. All of this means that absent a sea change in delivery patterns and/or reimbursement, enthusiastic, well-financed providers still have ample time to build and anticipate an attractive exit.

Jeff Gerlach: Sellers are most interested in maximizing valuation. In addition, they are looking for cultural fit and stability for their employees. There continues to be plenty of interest, with several larger platforms being active in the acquisition space. In addition, local health systems have been active, looking to fill their need within the continuum of care as they go at risk for managing populations. PE also continues to be active but typically is looking to invest in larger platforms with sophisticated management teams and infrastructure.

Scott Witter: It's probably not a bad time to contemplate a sale, because the demand is certainly there—especially for larger multilocation practices. We see sellers with a variety of profiles. We often see retiring or near-retirement entrepreneurs who may want to continue in the business or gradually phase out over a few years. We also see overwhelmed entrepreneurs, who are pulled in too many directions, working too many hours and having a difficult time balancing the demands of the business. They often want to continue practicing and return to a normal work–life balance. We see operators who are looking to expand their business yet need outside capital and operational support, and we often see financial owners who are at the stage where they are looking to realize a return on their investment.

Blayne Rush: If you look at the stage of the life cycle that the urgent care market is in, you will see that we are north of 60% up the rapid-growth-stage curve. This is when the largest number of entrants are in the market, and thus the greatest number of buyers are competing for urgent care businesses. While the market is very good for sellers, there are many challenges facing them. The sale process is what some would call brutal, if you have never been through it before. The due diligence alone is overwhelming to most. Buyers are picky in what they buy and the amount of risk or challenges they are will to take on. While a center might be an A-plus center, if it does not present that way on paper, then the buyers are not going to help you clean up everything and prepare the business in order for you to maximize you price or be attractive. The beauty is in the eye of the beholder, and this is a small world. You get one chance to make the buyers see all the value that your business has to offer.

The Role of Private Equity in Growing Urgent Care

Alan Ayers: What is the role of PE in the development, growth, and financing of urgent care, and how do you see this role changing?

Blayne Rush: Historically health-care players have not been good collaborators, and PE is composed of well-experienced collaborators. PE groups are able to bring many players to the table and help them work together, to add sophistication and capital. As you can see from historical activities in urgent care, the PE groups take a platform and build it up fairly quickly, and many times sell it to a payor or hospital. This will continue. Many PE firms are seeking to capture this opportunity by acquiring a well-positioned group of clinics or centers and then growing their investment through the consolidation of smaller regional or specialized players and by de novo development. So you have a fair number of PE groups who are looking for an initial platform acquisition—an urgent care company that owns and operates multiple centers and has a strong management team in place. They look at businesses with $1 million

or more in EBITDA [earnings before interest, taxes, depreciation, and amortization], but the million is on the small end and would go to a smaller fund. The larger the EBITDA, the more attention you will get. Financial sponsors will also support consolidation among some of the larger platforms. Additionally, PE supports innovators such as GoHealth and CityMD. This will grow. PE is good for the urgent care market.

Scott Witter: PE will continue to play a crucial role in providing capital and operational guidance to entrepreneurs who are looking to significantly grow their business. Although there remains a tremendous amount of interest in urgent care by PE, I think some PE groups are beginning to understand that the relative difficulty of operating, managing, and growing urgent care chains, coupled with compressed economic returns brought on by high valuations, has made investment in urgent care less attractive. PE's ultimate goal is to maximize the return on investment capital, so some groups are focusing on smaller acquisitions where the valuations are more reasonable or have moved on and are looking at other dynamic but less-expensive health-care sectors.

Dexter Braff: Unquestionably, PE has played an extremely important role in fueling the surge in urgent care M&A. By our count, there have been at least 30 PE investments in urgent care in just since 2011—a number that trumps the rush of PE activity we've seen in the other health-care service sectors we cover. This in turn has stimulated activity from other strategic players who have been drawn into the M&A market to project their turf. Moreover, with greater access to debt, PE can afford to pay more in this increasingly competitive market and still generate outsized returns—boosting valuations across the sector.

Jeff Gerlach: As mentioned before, PE continues to be quite active. They have invested in large platforms with sophisticated infrastructure and management, as well as in the pure de novo space, recruiting a management team with industry experience and building a platform from scratch. As long as the market dynamics remain favorable, I would see this trend continuing.

The Role of Hospitals in Urgent Care

Alan Ayers: What role are hospitals playing in the urgent care space? Do you see the role of hospitals changing with the formation and growth of ACOs?

Jeff Gerlach: Hospitals and health systems continue to be active in urgent care, utilizing both acquisitions and de novo development. We receive calls every month from a hospital or health system somewhere looking to partner in an effort to solidify their urgent care strategy. The two primary drivers for this are (1) preparing for the changes within the system as providers begin to go at risk for managing populations and (2) securing the referral base for their other service offerings.

Scott Witter: Hospitals are increasingly serious participants in the urgent care space and have been much more active in acquisitions. As hospitals take on more risk for their patient populations, they are

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financially driven to find cheaper care options for treating non-life-threatening acute illnesses or injuries that would otherwise end up in the emergency department. As hospitals evolve into ACOs that manage populations, urgent care gives them a cost-effective way to manage risk as well as a source for referrals. I think we are certainly in the early stages, because hospitals are still figuring out the ideal partnership structure with urgent care, whether through outright ownership, joint ventures, or other options.

Dexter Braff: While fee-for-service continues to survive, hospitals are turning to urgent care as a means to funnel patients into their delivery systems. That said, even as health care inexorably moves from fee-for-service to population management with bundled, global, or capitated payment schemes, hospitals see urgent care as a critical gating mechanism to control costs, directing patients to the most cost-effective treatment settings (and out of the emergency department). Accordingly, it's a rare hospital that doesn't have an urgent care strategy. As for whether they can develop the consumer-oriented customer satisfaction mind-set necessary to successfully compete in urgent care? That's another story entirely.

Blayne Rush: 2014 was a big year for hospitals, and they are not slowing down in 2015. Last year HCA purchased CareNow, which has 24 centers in the Dallas–Fort Worth market and had a $30 million EBITDA it was said to have traded around 14 times, which is somewhere in the $420 million range. That was a great strategic transaction. Hospitals are looking to expand their market by putting flags in the ground staking claim to their ever-growing market territory. Some hospitals are open to looking at centers in up to about a 30- to 35-mile radius from their campuses. They are looking for access to patients and the revenue streams. Additionally, as health systems evolve into ACOs, they want to get their members to the most appropriate and lowest-cost setting, and urgent care fits that role. The advanced health systems understand that urgent care is a vital access point into their systems, but many have not been successful in launching platforms on their own. I believe we will see more health systems come to the realization that they are not set up to take on retail medicine and are challenged with evolving with consumerism, and that is why they want to invest in an existing platform or develop an affiliation. Many ACOs, regardless if they are physician led or hospital led, center around the primary-care docs. The challenge is that primary care is booked up with disease management—hypertension, diabetes, emphysema, and wellness. You have a dreadfully long wait after you show up for your 3-week-out appointment on time in a typically unpleasant waiting room with year-old magazines. If we look at where health care is going and we compare that with where urgent care is headed, we will see almost a pure overlap.

Urgent Care Valuation Trends

Alan Ayers: What trends are we seeing in valuation for urgent care? How are practices valued, and how do owners increase the value of their practices?

Jeff Gerlach: Overall valuation expectations have increased. There are numerous methodologies for valuation that buyers use, the most popular being a discounted cash flow methodology. The purchase price is then expressed as a multiple of EBITDA, because the concept is easy to understand. Large platforms with sophisticated infrastructure and management teams have been trading for double-digit multiples of EBITDA, while smaller operators are trading at considerably more conservative multiples. The overall desirability of the business (strategic value, stability, growth potential, provider engagement, etc.) can have a considerable effect on the value.

Scott Witter: With the larger multistate operations, valuations seem relatively elevated, but for smaller local multilocation practices, the valuations drop considerably. People tend to fixate on multiples of earnings, but from my perspective multiples of earnings are more historical reflections of value rather than a forward driver. Most buyers are going to see value differently and have very different perspectives of what they can accomplish with a particular acquisition. Buyers are paying for what they think they can do with a business going forward; thus valuations can vary considerably. One way for a seller to potentially increase value is to clearly communicate to buyers the variety of opportunities for growth or operational improvement. If clearly presented to a buyer, whether it be new clinic initiatives, better payor or purchasing contracts, operational cost savings or staffing reductions, it could be reflected in an improved valuation.

Dexter Braff: Valuation is typically based on a multiple of earnings before EBITDA. But the multiple is not an arbitrary figure. It is a function of two primary variables—risk and growth. Reduce risk and/or increase opportunities for growth, and your multiple (hence, value) goes up. Add locations, and you reduce specific market risk and increase opportunities for growth. Build predictable revenue streams—contracts, steady referrals, marketing programs, narrow networks—and reduce performance variability. Develop a management team to reduce the perception that if you go away, the business

goes with it. Create new programs. Even better? Develop the infrastructure, procedures, and experience to open new locations. And lest we forget: strive for efficiencies to increase the EBITDA that ultimately gets multiplied.

Blayne Rush: I get about five calls a week that after about 5 minutes the caller is asking what their business is worth, and I tell them it is worth as much as someone is willing to pay for it. We are in an emerging market that is very much growing, and many of the smaller groups have significant inefficiencies. This all bodes well for the valuations. When we speak of valuations or deal pricing, the default is to discuss it in terms of multiples of EBITDA, but EBITDA is backward-looking, or a historical view, and you can influence EBITDA. Some buyers do buy on the basis of a multiple of EBITDA, but the reality is that the more complex transactions will be valued via a discount cash flow method or a Gordon growth model or some hybrid, and then it is communicated as a multiple of EBITDA. There are buyers who feel comfortable with looking at your EBITDA, the EBITDA-to-revenue ratio, which is the percentage of profitability, as well as at some other metrics that they feel are important, such as patient volumes, case mix—the acuity of the patients—payor mix, etc., and then making an offer. Competition, like anything else, plays a part in this. Inefficiencies play a part in this as well. Many of the smaller businesses have 10% to 20% profitability, and when a more experienced operator takes over, they can typically run the center more efficiently. For the small transactions, we are seeing 5 to 7.5 times the larger deals. We are seeing deals go as much as 15 times larger. We are seeing the smaller transactions receiving higher offers than historical, and the larger ones are staying steady and maybe a little down for some, but remember the devil is in the details of the deal.

Transaction Red Flags

Alan Ayers: What red flags do you look for in potential transactions?

Jeff Gerlach: There are numerous red flags that we look for in considering an acquisition. First, we really want to understand if there are any compliance concerns. In addition, we want to ensure that the business can be integrated seamlessly into our platform and that the services being offered are consistent with our core business. Sellers, if physicians, who are looking to sell and exit immediately are a concern, as are influential people within the staff who are disruptive. Overall, we just try to do everything possible to ensure that the earnings we are monetizing will be consistent in the future.

Scott Witter: We look for operational issues where the two organizations may not be a good fit. Some common concerns are differences in the revenue management process that cannot be reconciled or issues with providers or staff where we perceive a difficult transition (contracting problems or credentialing concerns, discipline issues, etc.). Acquisitions are long, complex, difficult, and expensive processes where the parties are trying to build trust and come to a consensus from a variety of differing perspectives. Red flags occur when a seller seems unprepared or uncommitted to the process or is not forthright with potential issues in the business. Most issues can be worked out if put on the table early; however, when left late, they can be very damaging.

Dexter Braff: By far, the red flag that draws the most attention is anything to do with compliance—or more accurately, the lack thereof. This is particularly so as it relates to government reimbursement, which may become more relevant to urgent care providers as newly covered Medicaid beneficiaries (care of health-care reform) that lack primary-care provider relationships access the health-care system. Upping the ante is the fact that compliance is a go/no-go pivot point. If a buyer senses any problems in this area—whether intentional or just innocent error—the response is not to reduce pricing to reflect the added risk. It's to shut down the deal entirely to avoid scrutiny and tarnishing consumer trust.

Blayne Rush: Many red flags that can quickly turn into deal killers, but if the seller had addressed these during the preparing-to-sell stage, they would have been full speed ahead. The point is that in reality we are what we are perceived to be until such time as we convince the parties that we are something else. Negative perceptions create needless hurdles. What some urgent care business owners fail to understand is that this is a sales process. The more attractive your business is, the more someone will be attracted to it, and the more attractive it is, the more valuable it is. You also gain trust when you make the process easier on the buyer. ■

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