KEYNOTE INTERVIEW

Tailwinds grow in healthcare services

Buoyed by growth trends, buyouts in the lower mid-market offer significant opportunities for value creation, says Vesey Street Capital Partners' Adam Feinstein

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Q How do you think about the opportunity to invest in healthcare services today?
We see a massive opportunity to deploy capital in the healthcare services sector right now and are seeing evidence that private markets have become more buyer-friendly in the current environment. As specialists in the healthcare space, we are ultimately positioning ourselves for the next 10-plus years and will do so by taking advantage of today's fiscal environment and the dislocation that is currently out there.

Indeed, healthcare services companies have historically outperformed in downturns. We expect healthcare assets to be trading at attractive valuations and want to double down in seeking strong returns. We have seen similar cycles in the past and are convinced that investments in the current market will do very well over the next decade.

We also see a rise in interest from lower mid-market companies and owners seeking partners to help them navigate the current environment. A lot of private equity-backed platforms are not looking to do transactions right now because the market has been very volatile, but businesses owned by founders are looking for support in these challenging times. Additionally, we see more opportunity to deploy capital in corporate carve-outs as larger healthcare organisations re-evaluate their own divisions as the cost of capital increases with interest rates.

Q What trends are you seeing in healthcare services and how would you define your key investment themes in this sector?
We have historically been open to looking at all aspects of the healthcare

services sector, but today there are a number of themes that are particularly topical. First, we believe that the healthcare distribution and logistics industry is experiencing a period of accelerated growth driven by emerging technologies, specialised product pipelines, demand for real-time visibility and the rising cost of goods.

Next, we believe consumers taking ownership of more of their healthcare dollars will have a meaningful impact on care delivery in the future. We expect aesthetic medicine and consumer wellness services, which are still relatively nascent subsectors, to flourish in the current environment.

Meanwhile, labour shortages are impacting healthcare providers even more than in other areas of the economy, driving strong demand for companies that can assist with healthcare staffing services. Elsewhere, life sciences organisations such as drug companies and biotech companies are spending more money to develop new products and need assistance with this complex process. We do not invest in pharmaceutical companies themselves, but we want to provide services to drug companies and contract research organisations to help them develop new products and get them into the market.

Lastly, we believe payors and providers are increasingly looking for companies that can help lower the cost of care, manage patient populations and facilitate greater integration into care delivery networks. This is all part of the new value-based care models where provider groups are taking on more risk in terms of managing these patient populations and are looking for organisations that can help them do that as efficiently as possible.

Q Can you provide an example of how value-creation levers have been applied in practice in the healthcare services sector?

One example is AirSculpt Technologies, a business that provides body contouring and fat removal services through minimally invasive liposuction. We invested in the platform at the end of 2018 and, since that time, the company has exhibited dramatic growth.

There were four key pillars to the value-creation strategy. First, we focused on accelerating the business's de-novo strategy by providing access to capital and resources. In 2018, when we first invested, the company had six centres. Today it has 25. We have been able to create value by expanding the number of locations and have just opened the company's first international site in London. Furthermore, because the business is very capital efficient, we have been able to fund all that growth with internally generated cashflow.

For an organisation to go from six to 25 locations in under five years meant that additional executive talent was also required to help scale the business. We were able to partner with executives who we had worked with at previous portfolio companies, bringing in a chief executive officer, a chief operating officer and a chief financial officer. In addition, we were able to drive operational efficiencies, which led to good margins throughout the ownership period.

Finally, due to the strong free cashflow characteristics of the business, given that all procedures are paid for prior to the patient encounter, the company does not have any accounts receivable. Not only were we able to use that free cashflow to fund growth, as I have mentioned, but we were also able to return all invested capital back to our LPs in under three years. As a result, this was a successful investment and today AirSculpt is a publicly traded company.

Shaping up: AirSculpt Technologies expanded from six to 25 sites

Q What do you look for in the businesses you back?

We focus exclusively on lower mid-market buyouts in the healthcare services space. We invest predominantly in founder-owned businesses and corporate carve-outs. We have a long history of supporting businesses that offer services to hospitals, physician groups, payors, consumers and life sciences companies. Within that, we invest in asset-light business models with high barriers to entry that have strong cashflow characteristics and limited regulatory risk.

A hands-on approach is key, and we like to partner with management teams when it comes to developing strategy and executing on value creation. To

date, the firm has consummated 37 transactions across 10 platform businesses and has deployed over $600 million of equity.

Q Why have you chosen to focus on the lower mid-market within the healthcare space?

We invest in the lower mid-market because there is more inefficiency there. We can buy assets at more attractive purchase price multiples and, as a result, return characteristics are more robust. At the same time, we feel these assets are very attractive acquisitions for strategic buyers in the future given the growth opportunity that remains.

We define the lower mid-market as companies with EBITDA of approximately $10 million and that is our sweet spot. However, we have invested in companies with EBITDA as low as $5 million and we have invested in some slightly larger businesses as well. The purchase price multiples in this segment are approximately 9-10x EBITDA, versus the 11-12x average we have witnessed for larger healthcare services transactions.

Q How are you differentiated within that segment?

We are not trying to cover every sector. Instead, we have a focused strategy that allows us to leverage our healthcare services industry knowledge and network. We like to say that we invest in growth companies at a reasonable price. At the same time, we do not invest in companies with significant government reimbursement exposure.

We spend a lot of time thinking about risk mitigation and tend to use less leverage than a typical private equity deal. Our target leverage ratio is 2-3x EBITDA. That is important for us because, of course, we do not know where rates will be in the future, and we want the ability for the company to have a clean balance sheet to support both M&A and organic growth opportunities. Our value-creation templates are focused more on improving performance rather than relying on the financial engineering associated with high leverage.

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Q What is your sourcing strategy, and what are the nuances to sourcing founder-owned businesses versus corporate carve-outs?

In terms of sourcing, we do not typically purchase businesses from other private equity firms. Instead, we tend to do deals with founders who are looking for a partner to help them grow and scale the business.

I would say that our story resonates with these founders because we understand their business model and have a long-term perspective. In addition to developing a value-creation plan to better align interests, we help founders find executive talent to scale the business and develop a robust strategy that they can communicate throughout the organisation.

With respect to carve-outs, we have completed three carve-out transactions and those are a function of our relationships with sellers, such as large healthcare companies. We seek to buy non-core segments, that are great businesses but have not been a key focus for these larger organisations. These are typically not auction deals, so it is all about relationships and trust. The seller is looking for a partner that they know can move quickly and be a good steward for that business post-transaction.

Q What metrics do you look at in evaluating investment opportunities?

We are very focused on free cashflow generation. All of our portfolio companies have robust free cashflow characteristics. We believe that the markets overvalue revenue growth and often ignore these free cashflow trends. This is important because we can use portfolio companies’ cash to fund M&A and de-novo site growth.

Since we invest in companies that are not capital intensive, we also have cash to make distributions to our investors, and in many of our transactions we have been able to return most of the invested capital to our investors prior to exiting the investment. ■

Adam Feinstein is founder and managing partner at Vesey Street Capital Partners