McGuireWoods

THE CORNER SERIES

Start With Fundamentals to Help Healthcare Investors Succeed, With Mike Murphy

Episode Summary

The days when healthcare investors could financially engineer their way to an outcome are gone. In today’s economy, they must focus on improving valuation and performance. In this podcast, McGuireWoods partner and host Geoff Cockrell and Mike Murphy, founder and managing partner of Sunstone Management Advisors, discuss how to succeed in this harsh reality.

At Sunstone, Mike leverages his four decades of experience in the healthcare insurance space to help small to mid-sized businesses improve their enterprise value. For Mike, it starts with uncovering the fundamentals of a client’s business: Are the messaging and targeting right? Then there’s the execution around selling into the payers, which is not for the faint of heart, Mike says. The CEO should be the thought leader, not the salesperson.

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 (00:20):

Thank you for joining another episode of The Corner Series. I'm your host, Geoff Cockrell, partner at McGuireWoods. Here at The Corner Series, we try to bring together deal makers, thought leaders, at the intersection of private equity investing in all things healthcare. Today, I'm joined by Mike Murphy, managing partner and founder at Sunstone Management Advisors. Mike, if you could give a little bit of an introduction of yourself and Sunstone before we jump into some questions.

Mike Murphy (00:46):

Sure. Yeah. So, real quick bio. 40 years experience in the healthcare insurance space. Started my journey inside large company, then branched off into more entrepreneurial I would describe, which is bill fixes in charge of large organizations. And then, most recently, have spent really the back part of my career, C-suite, CEO of small to mid-sized businesses, all in the healthcare and insurance space. On the healthcare side, not so much life sciences, bio research, that kind of thing, but everything else, provider, managed care, provider services, payer services, that thing. And then, on the insurance side, all things life-ex and health. So, there's no part of that I haven't touched.

(01:26):

And Sunstone Management Advisors is a management consulting firm. Our roots go back over 20 years, but we are singularly devoted to helping small to mid-sized businesses primarily improve their enterprise value. Our tagline is Go Beyond. And so, we try to work with boards and executive teams that are looking more from their business than they're getting. And we bring expertise, 9 or 10 of us deep backgrounds, C-suite executives with absolute track records, and primarily how to improve, even grow enterprise value growth strategies, that sort of thing. That's us real quick in a nutshell, and I look forward to having a conversation with you today.

Geoff Cockrell (02:09):

So, Mike, for quite a while in healthcare investing and especially in provider services, there was all tailwinds. The cost of debt for acquisitions was as close to zero as you can conceive of for a long period of time. The differential in valuations from smaller businesses to larger businesses was big enough that you could kind of acquire things, patch in smaller pieces that you bought at a lower multiple. And that recipe just more or less worked.

(02:44):

The current environment is different and there's a lot more discussion around how to improve performance, that the ability to just financially engineer your way to an outcome has gone down. That was never anyone's sole strategy. But now, you really need to improve valuation, improve performance. I'm sure that's bringing you into more situations. How would you describe that generally? And then, I'd like to delve into a few of the areas where you see the low-hanging fruit on valuation improvement.

Mike Murphy (03:13):

Sure. Obviously, I agree with your assessment of the market, the halcyon days of 10 to 15 times trailing EBITDA and having money thrown at you for the latest technology and opportunity is long gone. And the residual of that is obviously you're seeing more in the way of down rounds. You're also seeing investors with the kind of difficulty, and obviously the cost of capital changing more and more pressure on truly exponentially growing the enterprise value as a way to realize their investment and allow that through growth strategies. And then, there's no doubt significant headwinds in the growth side, particularly in the payer provider services world.

(03:50):

There's single point fatigue. It's harder and harder to get products commercialized, particularly if you're wholesaling and trying to sell into the big ecosystem, whether it's healthcare, big healthcare players or big insurance payers. So, we're seeing that conundrum right now where executive teams, where they was kind of sailing along and valuations were good, and now you see the harsh reality of today's economy and the executive teams, and investors are challenged to figure out a way to get that growth going.

Geoff Cockrell (04:22):

So, let's take, not a startup but a cash flowing business. Let's say it's a founder owned, founder operated. If you're engaged to assist them, let's take, not provider services, but you mentioned farmer services, payer services. Let's take one of those. What would be in your toolkit of things that you could address most commonly when you encounter a company like that that could be transformational for their value?

Mike Murphy (04:50):

Sure. So, the first thing is generally, when we start to get engaged, there's a belief on a single point of issue, right? Our problem is our sales aren't any good, or do you have a Rolodex that you can bring us into places? And so, that's where the conversation starts. And usually, it's really around top line, less around kind of EBITDA, that sort of thing. But kind of, once we engage, what we try to do is kind of peel the onion back, and I do a real simple formula, right? And so, especially founder owned, right, because the founder owned is going to have that intrinsic belief in their product. They raised capital on it, they're either cash flow positive or slightly below. And so, there's success telling them that they've got the right idea. Not necessarily want to challenge that, but there's a little bit of that, right? So, we say, "A equals B, B equals C, A equals C." Right?

(05:39):

A, I have a great company that's doing great stuff and we have great teams and it's executing. B, I have a thriving market that wants my product, wants to buy it, and I have a competitive advantages. C, I have a highly successful financial results company. And invariably, when you go back in, A equals B, A equals C, that math kind of falls apart. And variably, there's something more to it than just, "We don't have the right sales team or we need a new brochure," or something along those lines. And so, part of what we try to do is get grounded on making sure that the strategy still holds up, that there's an understanding of what the total addressable market is. My personal belief is that, especially the entrepreneurs and they've got great technology, as they leave with their technology, they fall in love with their technology, and the average payer services buyer gets kind of lost in it, and they're not clear on what exactly their product does and doesn't do.

(06:37):

We start with really fundamentals and making sure that the targeting is right, the messaging is right, and then we get into the execution. And the execution around selling into the payers these days is not for the faint of heart. The sales cycles are hideously long. And in fairness to the payers, if you are an average CIO, chief marketing officer, COO of any sort of payer, you're getting 20 to 30 phone calls a day from the latest gizbot that's going to make your life easier. And in the past, they got burned with those things. So, there is a real headwind from a distribution perspective on trying to get these products commercialized. But for us, we start off with is that, we're not just going to run out and give you a brochure or work with your sales team on messaging. We kind of back up a little bit, let's make sure the fundamentals are there in terms of your messaging, what your product does, and then that will inform the sales execution, the messaging, the distribution strategy, if you're talking certainly about a revenue strategy.

Geoff Cockrell (07:36):

Maybe give a couple, little bit more concrete examples of where exactly a company might be able to make specific improvements that could change that trajectory.

Mike Murphy (07:46):

A couple things. One is, especially founder-run businesses have a tendency to, in my practical experience, both having to work for them and then consulted with them, the CEO founder is the Sherpa, the God that the whole thing is built around. And a lot of times, their distribution, their way they're teed up is that the CEO gets featured too much in the sales process. And when the CEO jumps into the first chair and is actively selling, it instantly makes the businesses look like it's run out of a garage. So, one of the first things we talk about with a founder-run business is to build a distribution where the founder, the innovator, the thought leader is preserved as that in the sales process, in the founder's presentation. Not, "Hey, I'm going to grab the microphone, sit first chair and try to close the deal." And that's hard because if you're earlier stage, even if you're cash flow positive and you're in selling to a big payer, that's a big deal on the table.

(08:44):

You want to be actively involved. But the challenge is, as CEO, you've got to play the role of thought leader, corporate guarantor performance, not salesperson. Sounds simple. Really, really hard to do because if you're an entrepreneur and you understand, you're like "Hey, we get this deal, this could be tens of millions of dollars of EBITDA." You're going to want to sit first chair. You got to avoid that at all costs. Second thing I would say is messaging, and as somebody that has purchased, been on the payer side and purchased it, a lot of these companies, everything's AI and machine learning. There's not a website you can't go to now that everybody talks about AI and machine learning.

(09:20):

Everything's AI and machine learning. And then, you get into, what do you do, right?? So, I ran health plans, I purchase services from payer services, and you go to the website and it's a lot of jargon and it's a lot of techie stuff, and they're not really good at really fine-tuning and zeroing in on their value proposition and proprietary distinction. They get caught up in selling the features of the tech because that probably was what attracted the capital in the first place, but it's not going to attract a payer client. So, those are the two things that just jumped to mind, which is making sure the CEO is properly cast. And then two is on messaging, please, please, please describe how your product makes the payer bigger, faster, better, cheaper, and don't get caught up in some of the technology jargon. And then, you go pick any payer services. The websites are fraught with this. And for me, as somebody that's purchased that outside, I just read your website, I have no idea what you do, and there's a lot of that out there.

Geoff Cockrell (10:17):

How often is the problem personnel? I've got friends that do management consulting and they've described, at least part of their role, in that from time to time as being what they bring is the will to make difficult people decisions. How often do you encounter that and what would your role in that context be?

Mike Murphy (10:36):

Yeah. Frankly, it's the bane of anybody like me's existence is, depends on how you're brought in, right? If you're brought in on behest to the board and the investors, management is going to be instantly on your heels, even though we go with the idea of trying to figure out a way to help all the parties and get going.

Geoff Cockrell (10:53):

But you're perceived as a threat right out of the gate.

Mike Murphy (10:55):

Oh, yeah. Yeah. And then the second thing is, even if you're not, I've had colleagues that I've known forever bring me and say, "Yeah, okay, look at this." And now, I call it that river at Egypt called denial, right? So, but then you're that guy that's got to point out, I had one conversation with a client and said, "Oh, we got a couple of tactical fires going, and so you're more strategic." I go, "No, no, we're tactical. We will come land, sea and air and help you put the fires out." And he goes, "Yeah, we got some tactical fires." Well, as we got out there, peel back the onion, it wasn't tactical fires. The second floor was engulfed. I mean, it was a mess, right?

(11:29):

But then, you're in that position where you're going to tell somebody something they don't want to hear. And I do think that managing change is the single biggest challenge that I think exists in the space, particularly the conundrum that exists today as we've described with the economic conditions and growth kind of stalling. And for somebody like me, how do I go in and say, "I hear what you're saying. I know you love what you're doing and everything's great, but your second floor is engulfed." Right? The house isn't going to survive unless you take measurable change. And that was a little test, right, based as a change meter. Scale of 1 to 10, here's where your goals are, here's where you are. Scale of 1 to 10, 10 meaning we got to blow it up and start over again, 1 we could fall asleep in our chair, we're going to get there.

(12:13):

How much change do you need to get to your goals? And invariably, the challenge is is that the twos and the eights, and if you have an exec team that's two and they think everything's great, even though it's the ultimate definition of madness, they keep chasing their tail. And then, with my experience and my colleagues' experience, we know it's eight, might even be 13, that's where it gets tricky. We're not always successful. Sometimes we have to just pull back and wait another day and wait for them to wake up and go, "Holy mackerel, this is a bigger problem. Can you help?" And hopefully it's not too late.

Geoff Cockrell (12:46):

Another kind of pressure point in a company's growth evolution that I encounter is when kind of they find themselves necessarily moving from an organic growth model to an acquisition growth model, just that whole process is different. Integration is different.

Mike Murphy (13:02):

Completely.

Geoff Cockrell (13:02):

What are some of the issues that you see arising that you're able to help them address?

Mike Murphy (13:06):

The first thing is is that, if you decide to go the M&A route, unless there's a core DNA in being able to obviously source, identify, measure and figure out just the whole return on capital, I mean obviously there'll be some help in it, but a lot of the companies they're buying are small that may not have all the discipline with regards to financials and all that. And so, navigating all of that is difficult. If you're buying other founder-owned companies, that's a real challenge, right? Because are you going to create a retirement gift for somebody to just sit behind the desk?

(13:40):

And so, just the fundamentals on just even getting to the deal can be challenging. Once beyond that, do they have core, do they understand the acquisition and how to integrate it, how to get through and get synergies? And my experiences that I've seen is that a lot of companies just kind of bolt things on, and they kind of leave things in place and they don't necessarily create that seamless look in the marketplace. Or the M&A strategy is simply, is another way to Spackle over a miss on the organic growth side.

(14:12):

So, what we try to help with is getting them to truly understand the synergies of the deal, truly understand how the whole is going to be greater than the sum of the parts, and then making sure that things get integrated. I personally have been part of, I put three companies together that weren't 100% overlapped in terms of face to the market, but we did do a lot of consolidation and a lot of consolidation of services, and squeezed a ton of EBITDA out of it even though it wasn't necessarily synergies in terms of operations, right? Because we had three different product lines.

(14:45):

Some shared customers, but really making sure that the core services were stripped down and that we were able to drive some change. And then, worked for companies where we said we just do acquisitions for the sake of acquisitions to show how we could do it. It makes no sense to me. Just make sure that if whatever the deal is, that you have the discipline to understand the synergies, that it is truly going to add to it. And then, have the organization and the wherewithal to actually put the companies together and truly digest them.

Geoff Cockrell (15:13):

As an attorney, a lot of what I do is identifying risk and figuring out strategies for kind of fencing it or containing it in some way, and that's on the legal front. But there's certainly got a business counterparts to that where I'm often surprised that I see companies that are truly taking binary outcome risk that they don't even perceive. What are some of the bigger ticket risk arenas that you see companies walking themselves into?

Mike Murphy (15:43):

A couple things. One is, just from a straight financial perspective, particularly early stage companies, concentration earnings is a real challenge. So, you see kind of the one anchor client that's paying all the bills and it can mask a lot of problems. Well, I got the one client. And then, obviously from the next valuation, the next round, especially today where people are going to be a lot more careful in their investments, they're going to see that concentration of earnings concern. So, that having, being leveraged by a large single client while it's paying the bills and is great, it is a real risk that has to be managed aggressively because one day the client goes away and your business is gone.

(16:23):

The second thing I see in terms of risk, it's indirect, but it's kind of a compliance thing, right, where especially on the payer services side. So, you've got a lot of things that are paying claims or stop-loss or things that are subject to various regulators, or whether it's department of labor or state. And failure to execute and perform, even in operations can bring in, you can relate to this, gargantuan legal and compliance risk, and life-threatening legal and compliance risk. And so, the day you don't pay a claim fast and on time, or you don't have the proper incentives in place to kind of deal with your providers, or you have not buttoned up your distribution from a regulatory and compliance perspective, is life-threatening, right?

(17:11):

You can get shut down, you'll cease and desist, and that's the other part. And then, the last thing I think I see is lack of a proper instrumentation panel. There's a lot of people flying a plane by the seat of their pants, and they miss things and they don't have that view of their business, and they don't necessarily understand where they're making money and not making money, and they have premises that may or may not be correct. So, as I think about risk factors, so those are the three things that kind of jump to mind for me.

Geoff Cockrell (17:40):

Those also can present opportunities for partnering with someone from the perspective of a sale transaction. I do private equity work, and I had a private equity fund client that described it to me as, you can fly a little plane by just kind of looking out the window and looking for landmarks, and flying along in nice clear days. If you're flying a bigger plane, you need instrumentation to be able to do that. And he described part of what he was looking for in acquisitions is a pretty decent sized plane where he can see the guy up in the front just kind of looking out the windows to figure out how to drive.

(18:17):

So, it's certainly the case that's a catalyst for kind of moving up. But within the vein of kind of partnering or a transaction, as you're advising people, what are some of the hallmarks of when a transaction is what they should be thinking about? And sometimes that discussion is kind of external to the business, meaning the founder is at an age or something where they need to be thinking about succession, but sometimes it's kind of, they've tapped into their skill set of things that they can grow, or they've hit the boundaries of what you can do without capital. What are the best kind of indications of when someone should be thinking about a partner/sale?

Mike Murphy (18:55):

So, and again, this is a little bit of window into the soul. What's the mindset of the founder, right? Do they have that kind of indomitable spirit that, no, they're going to bend the rubber tree plant no matter what, and then they know better? And, I mean, if you think about these entrepreneurs, I mean, they have developed, God bless them, developed ideas and concepts that didn't exist and get told over and over and over again, "It won't work, it won't work, it won't work." And they push through it. And it's a great skill set, but it also can be a fundamental failing, right? Because sometimes it's not so much you're going to fail, but sometimes you need to understand your headwinds and you need to be able to understand how to adjust. So, the first thing is with the founders, where are they in that headset? Are they the, a joker for the almighty, for Vogue? They know everything and the place can't run without them and nobody's going to tell them what to do?

(19:47):

And obviously, anybody looking to make an investment in that kind of mindset has to be careful because there's going to be evolution, right? The great founders, they're going to get to a point where they need to backfill themselves, and irrespective of their personal desire to go get sand between their toes, it's do they have that mindset where they can let it go? Or do they have the curiosity where somebody comes in with a different skill set and says, "I know we've been doing this, but if we go over here, it's a 90 degree veer off, but we can do some magical stuff." And is the CEO sufficiently open and flexible to kind of go with it and get to the next level?

(20:25):

So, I think that that entire conversation is driven by the leadership mindset and the head, if you will, of the founder CEO, because I think the rest of it falls into place because if they are that kind of driver driver, and again, there's time and a place for that, then they're not likely to bring anybody in and they're going to be single purpose and they're going to drive. And they may have a track record where it's been successful before, but more often than not, if it's, okay, we've got to a point, now I want to take some money off the table, I want to get some growth capital, that sort of thing, what kind of a partner is that CEO going to be?

(21:02):

And you've seen it too. Time and time again, there's the story of the CEO founder, got it to a certain level and took money off the table, 50, gave up seat control, and then private equity, VC private equity says, "Okay, well, we'll make you chairman emeritus, but we need to think about another CEO coming in and take it to the next level." So, I'd start with the headset of the founder, CEO.

Geoff Cockrell (21:24):

And how often, as you're kind of coming in to address kind of some impediments to growth, how often is the impediment the founder themselves?

Mike Murphy (21:33):

Yeah. A lot, right?

Geoff Cockrell (21:34):

Or at least part of them, or-

Mike Murphy (21:35):

Part of them. Yeah.

Geoff Cockrell (21:36):

... some diminishment of their own skill set in certain regards.

Mike Murphy (21:39):

Yeah. Because what generally happens is, especially there is a product centric mindset, right? "I created this thing, it's awesome. My salespeople are idiots that can't sell it." That's harsh. There are other parts of it where, "I can't seem to get to the decision makers. Can you help me figure out a strategy where I can work my way up inside the large payer organization?" But a lot of it starts with a fundamental belief that the product is great and it's working and it's wonderful, and that could be the case. I mean, there's a lot of really poorly run sales organizations out there that don't understand the intricacies of payer services, because it's not from the faint of heart. It's very difficult. It's difficult to navigate. It takes a long time, particularly if you're any sort of rip and replace solution. I mean, good grief. That could take a long time.

(22:29):

So, yeah, usually getting the diagnosis on what's the impediment of growth, there certainly can be founder resistance to that where we say, "Your product isn't sufficient to generate the kind of growth you're looking at. You have a single point solution that it works great, but your total addressable market is small and your barrier to try and get something done, you're just not going to get the bandwidth inside the payer. So, you're beating your head against the wall, and it's not necessarily because your sales execution." Or it could be sales execution where you have salespeople that are running around spraying and spraying, and don't have the discipline to really get in and understand the actual needs of the customer. Or maybe you need some third party help from a lobbyist perspective, lack of a better word, to help you get into the C-suite in some of these payers. And so, any and all of those issues are on the table anytime we're trying to engage in growth.

Geoff Cockrell (23:20):

Mike, we could talk about this for quite a while, but I think we'll end it there. Certainly seeing tons of interest in payer services, and that's become a very active environment, so I'm sure you'll be busy for a while to come.

Mike Murphy (23:33):

Yeah. I've lived in it and no warts at all. And so, yeah, there's certainly a tremendous, and that's because there's so many innovations that are taking place out there in the way of health and health improvements and things like that. And you can't really execute that through a B2C strategy in B2B, and the most likely place is go through pairs, but that has its sets of challenges.

Geoff Cockrell (23:53):

Absolutely. Thanks a ton for joining me, Mike. This was great.

Mike Murphy (23:56):

My pleasure. Thanks for having me.

Voice Over (23:59):

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.

(24:13):

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.