Opportunities in Healthcare Services

An Interview with
Mary A. Tolan, Co-Founder and Managing Partner;
Larry Leisure, Co-Founder and Managing Partner; and
Vance Vanier, M.D., Co-Founder and Managing Partner, Chicago Pacific Founders (CPF)


Mary A. Tolan


Larry Leisure


Vance Vanier, M.D.

EDITORS' NOTE *Mary Tolan is a Co-Founder and Managing Partner of CPF. She was the Founder, Chairman and Chief Executive Officer of R1 RCM, Inc. (formerly Accretive Health), a leading provider of comprehensive end-to-end healthcare revenue cycle management services, which she took public in 2010 with an initial market capitalization of $1.2 billion. Earlier, Tolan was Group Chief Executive of a $2.3-billion global resources group of Accenture and had a leadership role in taking the company public in 2001. She has received several honors and awards, including being named to* Crain's *Top 40 Under 40 list, the Ernst & Young Entrepreneur Of The Year in Services 2010 Award, Distinguished Alumnus at University of Chicago, and CEO of company awarded Illinois Venture Capital Company of the Year. She was elected trustee of the University of Chicago in 2009 and is a trustee of Loyola University. She received a B.A. from Loyola University in 1982 and an M.B.A. from the University of Chicago in 1992.*

Larry Leisure is a Co-Founder and Managing Partner of CPF. Leisure joined Kleiner Perkins Caufield & Byers as an operating partner in 2010 with more than 30 years of experience in the health and managed care industry. His consulting leadership positions include Ingenix Consulting (now Optum), where he led the Payer vertical; Accenture, where he was the Global Managing Partner for the Health Vertical; and Towers Perrin, where he led the Managed Care practice. From 2003 to 2007, Leisure joined one of his clients, Kaiser Permanente, in a senior executive role. In 2010, he co-founded Healthspottr, and he convenes an annual innovation summit meeting in conjunction with The Aspen Institute. He received his A.B. in economics from Stanford University and his M.B.A. in finance from the University of California, Los Angeles.

Vance Vanier, M.D. is a Co-Founder and Managing Partner of CPF. Dr. Vanier's career in healthcare and innovation has spanned over two decades and has included successful roles as wan investor, CEO, entrepreneur, and physician. Prior to CPF, Dr. Vanier was the President of Verinata, which was acquired by Illumina, Inc. in one of the largest venture-backed molecular diagnostic exits in the last decade. Verinata's product, a noninvasive blood test that can replace the need for amniocentesis in pregnant women, has revolutionized the diagnostic methods used in the field of obstetrics around the world since its launch in 2012. He managed the company's rapid revenue growth and achieved one of the fastest health plan coverage adoptions in the history of molecular diagnostics. Before Verinata, Dr. Vanier served as President and CEO of Navigenics, a preventative genomics company acquired by Life Technologies. Dr. Vanier received his M.D. from the Johns Hopkins School of Medicine and completed his residency training at the University of California, San Francisco, and Highland Hospital in Oakland. He received an M.B.A. from Stanford University, as well as dual bachelor's degrees with honors. He continues to serve on the clinical faculty of Stanford Medical Center as an Assistant Clinical Professor. He was named a Henry Crown Fellow of the Aspen Institute in 2011, recognized as one of San Francisco's Top 40 Under 40 in 2012 and Genetic and Biotechnology News' *GEN Ten Young Guns of Biopharma.*

COMPANY BRIEF *Chicago Pacific Capital, L.P. (cpfounders.com) is a strategic private equity healthcare investment adviser focused exclusively on making private investments in healthcare service companies and senior living communities. CPF actively partners with organizations focused on delivering the highest quality of service to patients, providers and payers. The firm seeks investment opportunities of up to $75 million of equity capital per opportunity in buyout and growth transactions for cash flow positive businesses.*

What was your vision in creating Chicago Pacific Founders?

Tolan: The original idea was born out of data. In the company I had founded, R1 RCM, we had all of the data for healthcare providers because we were processing their payments. What we were able spot in the data was that there were better clinical quality providers that also had good cost structure.

We realized that in any other industry, the high-quality, low-cost provider wins, and wondered why that wasn't naturally happening in healthcare. We found there was excellence in terms of clinical skill sets but there weren't a lot of strong commercial skill sets in the milieu.

If we could spot these entities that had better clinical quality and cost structures, which the country needs, we could then partner with the founders and help them grow those businesses, not just with capital, but with our accumulated networks and capabilities.

Larry had been running global healthcare for Accenture and had excellent relationships with most of the large health plans in the country. I had built R1 RCM which had partnered with many of the large hospital systems and Vance was an important ingredient because he is a doctor himself who had moved into being a commercial leader of growing companies and many of these founders that we are talking to about partnering want to be on that trajectory as well. We thought there was tremendous opportunity and that has proven to be the case. We thought we could use our networks to source proprietary deals and that has been the case as well.

Eight out of the nine deals we have done we sourced through partner networks as opposed to buying a company that is going through an auction process.

The whole idea was based on being a better partner to founders because we have been founders ourselves; we know what it's like to walk in those shoes which is something that has resonated with the founders we have partnered with.

Vanier: When we looked out upon the market of healthcare services, we had three observations. First, there was tremendous fragmentation and we were still very much in the early years of what would likely be a multi-decade period of consolidation for providers.

POSTED WITH PERMISSION. COPYRIGHT © 2018 LEADERS MAGAZINE, INC.

As an example, there are over 140,000 dental practices in the U.S. and, despite several years of consolidation, probably more than 85 percent of the market remains fragmented.

The second observation we had is that most investment dollars at that time had gone into drugs, devices and diagnostics and fewer of those dollars had been going into healthcare services. For those investors who were investing in healthcare services, it tended to be people who wanted to write very large equity checks for large platforms. We saw that, if we were willing to focus on the sub-$10 million EBITDA market, there was extraordinary opportunity.

The third observation we had was that the skills that those business leaders and entrepreneurs needed mapped incredibly well to the operating backgrounds that Larry, Mary and I have.

Every one of those business owners need revenue cycle management expertise or partnerships with hospitals or contracts with health plans or best practices with physician recruitment and retention. We saw the opportunity to combine our decades of experience doing all of those things to be able to invest and help those businesses grow.

Those were the early observations we had and led to the founding of the firm. As we now fast forward years later, every one of those observations has held true.

How much has the diversity of your three backgrounds within the healthcare sector helped in building CPF?

Leisure: It's one of those wonderful moments of serendipity where we have three people who knew each other, respected each other, and had very complementary skill sets that in combination are in large part exactly what each business needed.

It is important to note, however, that while we founded the firm based on the thesis that an operator-led Fund could be differentiated, we very quickly married our operating talent with terrific private equity transactional expertise.

For instance, we added Krista Hatcher, who comes with 20 years of experience, and were also delighted to recruit other investment professionals with traditional backgrounds. We really think it's the interdisciplinary nature of operator-led experience married to the transaction skill-sets that makes for a strong set up.

How broadly do you define the healthcare services sector when you evaluate opportunities for CPF?

The whole idea was based on being a better partner to founders because we have been founders ourselves; we know what it's like to walk in those shoes which is something that has resonated with the founders we have partnered with.

Tolan: We stay pretty much on the provider side with the exception that we like Medicare Advantage health plans.

We're not going to do a pharmaceutical deal or a packaging deal. Those are different milieus. We're focusing on the provider side where the delivery of care happens and where new care model innovation can bring about much better quality at lower cost.

We're spending more than double what other advanced countries spend and we're not necessarily getting better outcomes. There is a big opportunity for innovation to take hold.

About a third of our investments are in senior living including independent living, assisted living and memory care. These are investments in providing great communities and great experiences for people in their mature years. They can live in a lively community that might have as much going on during a given day as one would find on a great cruise ship. That is being led by John Rijos, one of our co-founding operating partners, and the former President of Brookdale. He is considered to be one of the best senior living operators in the global market.

The second area we look at is the specialty areas in healthcare that are conducted in an outpatient setting. We develop a perspective on which innovative models exist and which platforms we think have cracked the code on how to provide better quality and lower cost.

We grow those companies, not just by doing acquisitions, but through hiring and then providing a better professional experience for the doctors. Growth and retention for those we hire is important to us. Also, we're experts on opening new locations.

We also form strategic relationships, which strengthens our ability to give patients the best care.

The third area we invest in is care model innovators – those who are not just going to practice medicine on a fee-for-service basis but who are going to be accountable for keeping the population healthier and out of the hospital, and who will improve clinical quality.

We do this with our P3 primary care business and through other opportunities, again backed by our accomplished executives who have helped build billion-dollar businesses from scratch.

We really think it's the interdisciplinary nature of operator-led experience married to the transaction skill-sets that makes for a strong set up.

 POSTED WITH PERMISSION. COPYRIGHT © 2018 LEADERS MAGAZINE, INC.

If everyone is just trying to brute force things and there isn't visionary leadership, those businesses will generally have a less aggressive growth cycle.

We think this notion of new care model innovation where we align incentives with quality outcomes is a key area of focus.

Vanier: As Mary mentioned, we have traditionally focused on senior living communities and provider-based businesses. When we say providers, we tend to mean clinical businesses where patients are the customer.

For example, there are about 14,000 dermatologists in the U.S.; there are roughly 24,000 ophthalmologists in the U.S.; etc. It's those clinical areas and countless others where we see fragmentation and where we see the opportunity for the expertise of our firm's team to add value.

In aggregate, these kinds of clinical companies in healthcare services account for almost a trillion dollars of the U.S. economy – it is probably one of the last large cottage industries left in the U.S. of that size.

How valuable has it been to source opportunities internally?

Leisure: It's been tremendously valuable. We made three bets on ourselves when we started the firm.

The first one was that the combination of our decades of experience in healthcare would allow us to have enough relationships where we could proprietarily source deals and not have to respond to auctions.

The second bet was that we could recruit first-class CEOs who would resonate with the idea that we had been in their shoes at some point.

The third bet was that we would materially be able to help companies after we invested in them.

If we fast forward the clock, we will see that virtually every deal we have made has come through proprietary relationships.

The CEOs we have been able to recruit are exceptionally talented and many come from leadership of multibillion-dollar public companies, so that point has come through wonderfully.

The third bet has paid off through the tangible victories we have been able to achieve for our companies. For instance, I have been able to win great in-network health plan contracts for our portfolio companies and have created innovative partnerships with healthcare systems.

When you evaluate opportunities, how critical is the management team that is in place?

Tolan: The management team is extremely important because, when we have good disciplined leadership that identifies a great strategy and then executes, we have a scalable business.

If everyone is just trying to brute force things and there isn't visionary leadership, those businesses will generally have a less aggressive growth cycle.

We look at people who understand how they can create mechanisms for teaching and reinforcing, and how to continually utilize technology. The leaders set the tone for this.

Vanier: We are very thesis driven. We sit down and determine the areas in the healthcare economy where there is fragmentation or a supply/demand mismatch, where there are outstanding demographic issues which, more often than not, tends to be in the aging population, and where there are strong reimbursement trends.

Then we will map and spend over a year interviewing sometimes over 100 practices, medical directors from health plans, company executives, and every expert we can in the field to achieve a nuanced understanding.

Next, we will typically look for initial businesses or practices where we have very strong clinical leadership that is also entrepreneurial and business-minded and wants to take on a capital partner and build out a management team to take their business to the next level.

As often as we can, and it has been in virtually all of our investments, we look for the marriage of a specific business or medical practice that embodies terrific clinical leadership as well as executive talent that we can work shoulder to shoulder with to make our investment.

Will you discuss the strength of CPF's advisory board?

Tolan: Having George Schultz often leading and advising our board has been beneficial because everyone admires his wisdom. He also does a wonderful job at orchestrating a collaborative conversation with very senior people, setting the tone that makes that kind of person want to be part of a group.

We have articulated a desire to have a high-level of discipline around entry multiples and doing a better job than others in sourcing allows us to accomplish that.

POSTED WITH PERMISSION. COPYRIGHT © 2018 LEADERS MAGAZINE, INC.

We also have two types of expertise: one is healthcare and the other is from private equity advising on building great firms to last.

The value of our conversations stem from this level of expertise.

How important is it for CPF to stay committed to its strategy as you continue to grow?

Vanier: One of the things that has been very important to us and our investors is that we stay true and disciplined to our strategy as we continue to grow.

One of the benefits of being early movers in a multi-decade consolidation phase is the fact that strategies and the expertise we have built are certainly going to be reproducible as we grow.

Will you discuss the talent and expertise that you have been able to attract to CPF?

Vanier: When we launched the firm, we talked about building a blend of people with strong industry backgrounds and relationships with strong PE experience and backgrounds.

Early, there were assertions to be proven. What we have learned through these past years is that the industry insights and relationships are in fact really important in terms of qualifying opportunities and allowing us to accelerate key relationships, be it with large hospital systems or national payers.

We have been fortunate with the extraordinary talent we're getting from other investment advisers that have been at this for a long time. These people are voting with their feet to join CPF and recognizing the benefit of an operator-led strategy.

Our firm really loves healthcare and we love nurturing companies that can improve clinical quality.

How important has it been for CPF to maintain purchase discipline?

Leisure: One of the things that we committed to our LPs is maintaining a high level of purchase discipline. There are a lot of money chasing deals, a lot of deals are intermediated, and it's important for us to deliver on expectations from our LPs, to be thoughtful in terms of sourcing opportunities at appropriate multiples and then doing the things we say we're going to do in the hold period.

We have articulated a desire to have a high-level of discipline around entry multiples and doing a better job than others in sourcing allows us to accomplish that.

With such a fragmented market in healthcare services, what are your views on consolidation in the industry?

Vanier: We think we're in the early phases of something that is going to take quite a long time. Just to quantify, in dermatology as an example, we have already seen a few tremendous investment success stories, but there are 14,000 dermatologists and probably less than 5 percent of that market has been consolidated.

Dentistry probably has over 140,000 dentists still operating individual practices. That space has had a lot of private equity activity for close to 20 years now.

These platforms take work to build and because these markets are so large, the expectation is that this will be decades in the making.

How actively involved is CPF with its portfolio companies?

Leisure: I am probably one of the more active in terms of helping our companies physically with things like securing in-network contracts, getting higher levels of reimbursement, etc.

We're very hands on when it comes to buy and build, in terms of helping identify potential targets, qualifying those targets, structuring the deals for those targets - those are examples of where we're extremely hands on working with our portfolio companies.

Vanier: Mary has set up a very creative relationship for one of our companies with a major academic medical center. In my case, many of our strategies depend on the opportunity to be able to recruit physician practices and I have done road shows as part of the business development team that will attract other clinics.

All of us have been incredibly engaged and it has been part of the fun.

How critical is it for CPF to have a deep relationship with its investors?

Vanier: We feel very proud of our experiences for two reasons: we feel the weight of responsibility and are quite honored by those investors who came in and supported our strategy and as such, we maintain frequent lines of communication with them; also, many of our investors are extremely experienced in investing in the healthcare space and they have served as strategic partners as we look at investment opportunities.

Looking back at your vision in creating CPF, has the firm evolved the way that you expected and do you enjoy the process?

Tolan: We are very much enjoying the process and our team. They have great cohesion and vision and we're having fun every day. We get to work on problems of our choosing with people of our choosing.

Our firm really loves healthcare and we love nurturing companies that can improve clinical quality. People here feel that the work they are doing is meaningful.

I believe this company has exceeded my expectations. What I love about being in this private equity structure is that instead of working on one company at a time, we're getting to work on 10 companies at a time and it increases our field of vision.

Leisure: We are quite satisfied that we're going to be around a long time. I'm particularly gratified by the culture we have established. We're really building an organization to last that is very team oriented. We are building something that is quite unique. It's a very collegial environment – it's competitive and everyone drives each other to a higher level, but the collegial environment we have built is something that I am particularly proud of. Our people truly like what we're doing and like each other.

We have something that is going to stand the test of time and that is what I'm most proud of. ●

POSTED WITH PERMISSION. COPYRIGHT © 2018 LEADERS MAGAZINE, INC.