

SCALE Case Study

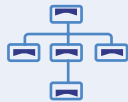
# Asset Diligence – Dental (DSO)

## Client Profile

**Size**  
21 locations

**Specialty**  
Dental

## Services Deployed



## Strategic Planning and Execution



## Data Analytics



## Performance Results

## Overview

SCALE engaged to perform a time-sensitive review for investor looking to expand its DSO asset into a new market via acquisition.

### Client profile

- + 21-location DSO in single state, providing primarily general dentistry
- + Target would add 7 sites, all in a new state.
- + Current DSO is generating \$39M in Revenue and \$5.9M in EBITDA
- + Target would add ~\$25M in incremental revenue and up to \$3M in EBITDA

Investment bank enlisted SCALE to stress test their model and assumptions and provide insight to relative strength, weaknesses and opportunities inside proposed deal, plus risk assessment.

## Execution

SCALE deployed its platform development consulting arm specializing in:

- + Strategy
- + Operations
- + Analytics
- + A dental-industry SME
- + Client required report delivered in ten days

SCALE reviewed a broad array of client-provided diligence and created an analysis of the current and future business focused on:

- + Performance Results
- + Cost Efficiency
- + Scalability
- + Leadership
- + Strategy

Each area of focused used provided diligence, stress-testing of the DSO's analysis, SCALE industry experience, and overview of current/future state of DSO market both from a national and geography-specific perspective.

Additionally, SCALE created an advisory summary of why DSO's succeed/fail to support the sponsor's go-forward asset management based on prior SCALE experience in turnaround & restructuring projects focused on aspiring national DSO's.

## Results

- + Deliverable completed and delivered to client on-time.
- + Deliverable successfully answered the sponsor’s questions using:
  - + Easy to understand presentation
  - + The deployment of analytics
  - + Decades of domain-specific industry insight
- + SCALE provided additional insight into best practices for avoiding pitfalls in scaling a local-to-national DSO.
- + SCALE analysis provided qualified feedback to the sponsor as to:
  - + Strengths and weaknesses in their baseline analysis
  - + Insight to additional areas that could provide opportunities to the DSO to improve base operations
  - + Re-oriented the sponsor to understanding that DSO performance should be looked at as a range of results
- + Benchmarking analysis to assist the sponsor in understanding the universe of DSO performance.
- + Identified areas of focus for the sponsor & management team to focus on to maximize the opportunities for success as they move from deal-close to near-to-long integration.

## Executive Summary

*Review of Diligence Materials Indicate a Well Positioned Company, with Opportunity to Improve the Base Business*

Key Themes For DSO Excellence	Key Takeaways
Performance Results	<ul style="list-style-type: none"> <li><input type="checkbox"/> Demonstrated track record of improving postclosing performance of acquisitions</li> <li><input type="checkbox"/> Doctor base that is younger, has a high percentage of ownership, and has strong retention among the <u>owner</u> base</li> <li><input type="checkbox"/> 4-wall EBITDA margin (14.5%) is below industry comps; primary drivers of this appear to be:                             <ul style="list-style-type: none"> <li><input type="checkbox"/> High hygiene compensation relative to revenue (RDH SWB = 60% of RDH rev.)</li> <li><input type="checkbox"/> Turnover / inability to ramp up associate doctor ranks (notably last 2 years)</li> <li><input type="checkbox"/> Historically having below-market reimbursement at select offices</li> </ul> </li> </ul>
Cost Efficiency	<ul style="list-style-type: none"> <li><input type="checkbox"/> There may be an opportunity to optimize supplies &amp; labs expenses; the extent of operational standardization in those areas is unclear from the integration playbook provided</li> <li><input type="checkbox"/> A benchmarking study would help identify opportunities / leverage buying clout</li> </ul>
Scalable Systems, Reporting & Analytics	<ul style="list-style-type: none"> <li><input type="checkbox"/> EDP has suite of centralized technology platforms; acquired practice integration plan includes centralization onto these platforms.</li> <li><input type="checkbox"/> Data reporting through Microsoft PowerBI</li> <li><input type="checkbox"/> New market integration represents new challenge for EDP team; focus in on RCM &amp; IT</li> </ul>
Strong Leadership	<ul style="list-style-type: none"> <li><input type="checkbox"/> Management team has DSO background; note SCALE has not met with leadership team</li> <li><input type="checkbox"/> Elements of centralized services may be missing e.g. Payor Contracting, Compliance)</li> <li><input type="checkbox"/> Diligence materials do not reference a Doctor Advisory Board, which many DSOs offer</li> </ul>
Holistic, Integrated Strategy	<ul style="list-style-type: none"> <li><input type="checkbox"/> With the exception of AMOS, EDP has deliberately focused exclusively on general dentistry and doesn't appear to have specialists in the network; opportunistically pluggingn specialty services to existing GP base could be highly accretive</li> </ul>

## DSO Benchmarks

Industry Comps Suggest Opportunity for Company to Improve 4-Wall and Consolidated EBITDA

(\$ in 000s, except per visit / patient metrics)

	D&O #1	D&O #2	D&O #3	D&O #4	Company
# Sites	295	249	89	34	271
# Doctors	655	392	132	72	681
Visits / Patient	1.8	n/k	3.1	n/k	2.71
Rev / Patient	\$427	n/k	\$538	n/k	\$730
Rev / Visit	\$238	\$222	\$173	n/k	\$273
Revenue	\$491,000	\$379,000	\$129,000	\$94,100	\$57,904
Same Store Sales %	3.0%	2.3%	n/k	0.0%	0.3%
4-Wall EBITDA	\$91,200	\$70,000	\$37,410	\$23,900	\$8,418
4-Wall EBITDA %	18.6%	18.5%	29.0%	25.4%	14.5%
EBITDA	\$58,000	\$31,000	\$30,000	\$19,000	\$5,002
EBITDA %	11.4%	8.2%	23.3%	20.2%	8.6%
Corporate G&A - % of Revenue	7.2%	10.3%	5.7%	5.2%	5.9%
Doctor Retention	87%	71%	94%	91%	79%
Hygiene Retention	85%	59%	84%	n/k	71%
% Doctor Owners	17%	34%	n/k	n/k	31%
<b>Revenue Mix</b>					
General	47%	53%	80%	49%	52%
Hygiene	29%	22%	-	-	14%
Specialty	24%	25%	20%	51%	34%
<b>Payer Mix</b>					
PPO & FFS	98%	84%	99%	n/k	88%
Medicaid + Managed Care	2%	36%	1%	n/k	12%

- Our preliminary analysis suggests underperformance is driven by:
  - Underperforming hygiene department. Co's hygiene compensation is ~60% of hygiene revenue; industry benchmark is 40%- 45%
  - Challenges with ramping and retaining associate dentists
- High level of doctor ownership has contributed to high retention at the owner level

## Discussion of DSO Underperformance

Primary Drivers of DSO Failure

Key Contributing Themes to DSO Underperformance	Risks
Weak management (executive, clinical & operational)	<ul style="list-style-type: none"> <li>□ Weak executive leadership can create systemic risk in any of the themes mentioned on this slide</li> <li>□ Need to develop strong bench of aligned clinical / operational leadership to provide sufficient network oversight</li> </ul>
Lack of alignment between operating model & infrastructure support	<ul style="list-style-type: none"> <li>□ DSO operating models can vary widely - e.g., general vs. specialty only vs. multispecialty; partner vs. employee providers; etc.</li> <li>□ Critical to confirm target go-to-market strategy and ensure alignment across go-to-market strategy, operating model and required infrastructure / resources for the same</li> </ul>
Poor provider incentives / alignment	<ul style="list-style-type: none"> <li>□ Ineffective compensation plans can disincentive production and / or contribute to poor site-level performance</li> <li>□ "Healthy" DSOs demonstrate a ~10-15% turnover in dentists; poorly run groups can be 30%+</li> </ul>
Failure to recruit & retain productive associates dentists and hygienists	<ul style="list-style-type: none"> <li>□ Need to build strong recruiting function that can hire productive doctors (without reliance on above-market compensation)</li> </ul>
Failure to integrate acquisition systems / operational standardization	<ul style="list-style-type: none"> <li>□ Deficiencies in reporting capabilities</li> <li>□ Inability to realize cost efficiencies</li> <li>□ Inability to apply "best practices" across network</li> <li>□ Owner buy in &amp; and qualified resource allocation</li> </ul>
Lack of succession planning for owners of acquired practices	<ul style="list-style-type: none"> <li>□ Many DSO acquisitions are with older providers looking to exit in 2-5 years post-sale. Ineffective recruiting capabilities to backfill these providers poses risk in that transition</li> </ul>
Weak data management	<ul style="list-style-type: none"> <li>□ Poor visibility into performance can lead to performance challenges and failure to address underperformance in a timely manner</li> <li>□ Ensure data is managed cross-functionally (e.g., align RCM &amp; Finance reporting)</li> <li>□ Lack of validation of KPI's supporting business decisions; lack of accountability</li> </ul>