Well Health Technologies (WELL.TSX)

If Warren Buffett & Mark Leonard Had A Baby

If Canada's known for two things, it's M&A roll-up companies and antiquated healthcare systems. The Maple Leaf's most famous roll-up company, Constellation Software (CSU), is a perfect example. CSU's strategy is simple. They buy <$5M software companies, take a passive management approach, and hold for the long term. So far, the strategy's worked for shareholders, with share prices rising 30x since IPO.

Then there's Canadian healthcare. In 2019, Canada ranked in the last quartile of healthcare modernization and digitization. Despite spending more money on healthcare than almost any country, Canadian's quality of care remains low.

To compare the digitization efforts, take Kaiser Permanente. In 2016, Kaiser Permanente delivered over 50% of its patient visits through telemedicine. In 2019, 90% of all Canada's appointments happened over the phone.

Of course, COVID-19 catalyzed this shift from in-person, paper castles to digital and over-the-phone appointments. A 2020 *CMA.ca* study showed that 34% of Canadian patients now use phone visits when they need advice from their doctor.

All signs point to increased Canadian healthcare digitization over the next decade. How will they get there?

Enter Well Health Technology (WELL). WELL owns and operates a portfolio of primary healthcare facilities in Canada and the United States. The company also provides digital electronic medical records (EMR) software and telehealth services. As of March 2021, the company owns/operates 27 medical clinics, provides EMR services to 2,200 Canadian medical clinics, and through its latest acquisition (CRH Medical), provides anesthesia services to 72 ambulatory surgical centers in 15 US states.

WELL's plan is simple. They're using CSU's M&A playbook in the digital healthcare space to buy attractive assets at great prices while holding for the long-term. The goal is to consolidate and modernize Canada's primary healthcare assets. Executed properly, the rewards for this strategy are in multiple billions of dollars or well above WELL's current market cap.

The strategy has worked well so far, with revenue growing at a 117% 3YR CAGR. But its latest acquisition, CRH Medical, is a game-changer. Thanks to CRH, WELL is now a near $300M annualized run-rate revenue business with significant EBITDA and FCF profile improvements.

The acquisition is important for two main reasons. First, CRH gives WELL a foothold into the US Healthcare landscape (a place they hadn't invested in prior). Second, the company can use CRH's FCF generation to invest in more accretive US-based healthcare buCAD 431Mnce the acquisition, the company raised 2021-2022 revenue guidance to CAD 270M and CAD $431M, respectively. Moreover, WELL is targeting ~22% EBITDA margins by 2022.

WELL's founder, Hamed Shahbazi, is one of the most shareholder-friendly CEOs we've seen. He has no salary and instead gets paid in restricted stock. He invested over $5M in the company to make himself the largest shareholder.

Here's why we're so excited: The above figures don't include WELL's most recent acquisition of *MyHealth*. *MyHealth i*s a leading specialty care, telehealth services, and accredited diagnostic health services provider that owns and operates 48 locations across Ontario. WELL's acquisition of *MyHealth* positions the company as the largest non-governmental owner-operator of outpatient medical clinics in Canada (74). Upon closing, WELL's combined revenue will reach ~ CAD 400M with ~ CAD 100M in EBITDA (25% margin) on a run-rate basis.

Li Ka-Shing, one of Asia's most successful investors and second-largest WELL shareholder, recently added CAD 100M to his position around CAD 9.80/share. Today the stock trades roughly CAD $7.7/share. In other words, you can buy WELL for ~3.7x run-rate revenue, 10x run-rate EBITDA, ***and*** at a 20% discount to Ka-Shing's latest investment.

WELL's Business Segments

WELL consolidates and modernizes digital healthcare assets through seven core business segments:

- **WELL Clinic Network:** Houses all wholly-owned medical clinic
- **WELL EMR Group:** Third largest Electronic Medical record (EMR) provider in Canada, serving 2,200 clinics and 10.7K physicians
- **WELL Digital Apps:** Encompasses all WELL's digital health assets, including apps.health marketplace
- **WELL Allied:** Majority stakeholder in SleepWorks, an expert in the treatment of sleep apnea and sleep disorders
- **WELL Cybersecurity:** Offers cybersecurity protection through its Cycura and Source44 acquisitions
- **DoctorCare, Inc.:** Canada's most prominent Billing and back-office services company
- **CHR Medical:** Provides anesthesia services for the Gastrointestinal industry

It helps to think about WELL's business through a golf analogy. Golfers carry 14 clubs in their bags at any given point. Each club serves a different purpose and utility. For example, you use a driver to hit it far and a lob wedge if you're going to hit it short. The golfer can use as many or as few clubs as she wants.

WELL's business segments are the golf clubs for medical clinics and doctors. Each wholly-owned medical clinic inside the WELL Clinic Network has access to these golf clubs. For example, if you have a patient that needs sleep work done, there's WELL Allied. Want to update your back-office processes? WELL offers DoctorCare, Inc.

In short, WELL creates a plug-and-play digital golf bag for medical clinics and doctors throughout Canada. The result is a better healthcare experience for the patient, smoother clinic management, and more patients seen per year.

EMR Software: The Snitch In The Healthcare Quidditch Game

Electronic Medical Record (EMR) software is the lifeblood of most medical clinics. Without it, doctors wouldn't have historical data on patients. This would make it nearly impossible to administer up-to-date care and treatment.

WELL's EMR Software is the golden "Snitch" in the game of digital healthcare integration. Here's why ERM's matter for WELL. First, the company can use its ERM reach (i.e., the 2,200+ clinics + 10.7K doctors) to cross-sell its portfolio of digital healthcare services. In other words, control the EMR, and you own other healthcare digital integrations. Today, roughly 18% of all Canadian doctors use WELL's EMR service in their medical practices and clinics.

Bears are quick to say that WELL's EMR software is open-source, not proprietary tech. While true, that view misses the bigger picture. EMR software is all about scaled network effects. WELL becomes an easier choice as more doctors choose to use its EMR software, whether it's open-source or not.

Another example of such scaled network effects is WELL's Cybersecurity segment. The more clinics and physicians WELL brings to its digital platform, the greater the need for those doctors and clinics to protect their data. In turn, this makes it easy for WELL to cross-sell clinics on its cybersecurity offering.

Catch the EMR, catch the clinics.

WELL's Allocation & Acquisition Strategy: Clinical & Digital Portfolios

We don't need to make the WELL bull thesis harder than it needs to be. The company will generate substantial value for shareholders if it can acquire great businesses at low prices and hold them for the long term. Full stop. Like Hamed Shahbazi, it's helpful to think of WELL's Investment Strategy through two portfolios: **Clinical and Digital.**

The picture below is from a presentation Shahbazi gave in 2019. Bifurcating WELL's investments into these two buckets allows investors to better track where WELL is investing and in what category. Here's an easy way to think about it. The Clinical Portfolio tracks WELL's wholly-owned medical clinics. Everything else falls under Digital.

Acquisition Strategy: Three-Pronged Attack

WELL invests in three types of assets: Primary Healthcare, EMR Service Providers, and Digital Healthcare Technologies. On the Primary Healthcare front, WELL seeks **family** medical clinics with established revenue histories, profitable operators, and a minimum of 1,000 patient visits per month.

For EMR providers, WELL seeks companies using either NerdEMR, OSCARprn, or KAI Innovations software. Finally, the company's Digital Healthcare Technologies investments focus on Digital Patient Engagement, Telemedicine, Big Data, Patient Portals, and AI.

As a general rule, WELL looks to pay between **3-4x EBTIDA for its Clinical Portfolio** businesses and between **4-5x ARR for its Digital Portfolio** companies. The company also wants to buy businesses generating **~20-25% run-rate EBITDA margins**.

Let's see two recent examples of WELL's investment acquisitions: CRH Medical and MyHealth.

CRH Medical & MyHealth: Medium-Term Catalysts For $400M+ Run-Rate Revenue

As we mentioned earlier, CRH Medical provides anesthesia services in 72 ambulatory surgical centers in 15 states and the patented O'Regan System hemorrhoid banding product across all 48 lower states.

The company acquired CRH in an all-cash deal using a $295M private placement in which Li Ka-Shing invested $100M and Shahbazi another $500K. CRH Medical is a transformative acquisition because it opens WELL to potential US-based acquisitions and revenue streams. Here are Shahbazi's comments on the purchase from WELL's 1Q 2021 earnings call (emphasis mine):

> *"CRH accelerates our revenue growth and significantly boost our free cash flow, which will obviously be used to make additional cash flow-generating acquisitions. This is when we're cooking with fire ... With the CRH Medical acquisition,* ***it's clear that WELL becomes not only a leader in the healthcare market in Canada here, but also a strong emerging player in the United States.****"*

WELL paid ~6.5x EBITDA and 2.7x revenue for CRH. The acquisition should add another incremental **$100M in run-rate revenue to WELL's top-line at ~42% EBITDA margins**, higher than WELL's average 20-22% EBITDA margin.

Adding CRH to the WELL family puts the company at a nearly CAD 300M run-rate revenue business with roughly 22% run-rate EBITDA margins.

Let's shift to the latest acquisition (as of June 7, 2021), MyHealth.

MyHealth

If CRH Medical was a home-run, the MyHealth acquisition was a grand slam. For CAD 206M, WELL bought a leading specialty care, telehealth services, and accredited diagnostic health services provider that owns and operates 48 locations across Ontario.

Once complete, the acquisition will make WELL **the largest non-governmental owner-operator of outpatient medical clinics in Canada, with 74 combined clinics**.

MyHealth has killed it as a standalone company. Over the last five years, they've grown revenue *and* EBITDA at 40% CAGRs. And in the previous eight years, they've completed an additional 25 acquisitions. Here are a few more headline stats:

- Founded in 2013
- Over 760 physicians and other healthcare professionals providing patient services
- Recorded over 500,000 patient visits, including primary, specialty, telehealth, and diagnostic visits in LTM ending March 2021.
- Offers medical consultations both in-person and through telehealth, as well as diagnostic services related to cardiology, women's health, bone/muscle health, and cancer diagnostics

There are also a few nuanced efficiencies MyHealth provides. First, the company already uses WELL's OSCAR Pro EMR in its primary care services business and its Insig patient in-take platform. Second, MyHealth brings an additional 160 physicians and 600+ healthcare professionals into WELL's platform. Finally, 75% of MyHealth's medical consultations are done via telehealth, which fits perfectly into WELL's Digitization efforts.

How did shareholders fare in this transaction? WELL used four levers to fund the transaction:

- $82M in cash upfront
- $94.3M through the issuance of 9.6M shares at $9.8/share
- $30M convertible note
- 4YR performance-based earn-out of up to $60M

In short, WELL diluted existing shareholders by ~5% to add an incremental 20% growth in run-rate EBITDA and 28% growth in run-rate revenue.

Touching on Insider Ownership

I usually don't spend an entire section dissecting major insider owners, but it's a must with WELL. The company's second-largest shareholder, Li Ka-Shing, is one of the world's greatest investors. His venture capital firm, Horizon Ventures, has a mind-boggling track record. Some of their investments include Celsius (CELH), Facebook (FB), Spotify (SPOT), Zoom (ZM), Slack (WORK), and Airbnb (ABNB).

The same team that invested in the above deals is investing in WELL. So Horizon Ventures sees something that the rest of Wall Street doesn't recognize.

CEO Hamed Shahbazi owns ~6% of the shares outstanding and does not take a salary. I don't think we've researched any other business whose CEO only took stock. Here are Shahbazi's thoughts on his stock-only compensation (emphasis mine):

> *"I've seen this movie before. When you bring together quality assets, quality people, and you cost optimize,* ***and you don't get drunk on debt,*** *an you run the business in a very practical way ... value goes up. Ultimately these assets go for a lot more than what we buy them for."*

Safe to say, Shahbazi would win the Marshmallow Test.

Valuation & Increasing Shareholder Equity

We don't need to overthink the formula for long-term increased shareholder value. As long as WELL acquires excellent businesses at reasonable prices and holds them for the long-term (without much shareholder dilution), equity investors will reap bountiful returns. MyHealth is an excellent example of this strategy. The company diluted shareholders ~5% to gain 20% and 28% revenue and EBITDA accretion. Investors should take that trade *every* day.

So, where do we stand now? Currently, WELL trades at ~ CAD 7.76/share or CAD 1.52B market cap. Subtract another CAD 60M in net cash on the balance sheet, and you get CAD 1.46B in Enterprise Value.

Post its MyHealth acquisition, the company should generate near CAD 400M in revenue and CAD 100M in EBITDA by FY 2022. In other words, you're paying ~3.65x 2022 EV/Sales and ~14.6x 2022 EV/EBITDA. That seems cheap for a company growing revenue from CAD 50M in 2020 to over CAD 400M two years later.

Let's venture further, out to 2025. Let's assume WELL grows top-line revenue at a 24% CAGR from 2022 to 2025. That gets us CAD 739M in revenue (<2x 2025 EV/Sales). We'll also assume WELL generates ~22% EBITDA margins by 2025 (given their history of at least 20% EBITDA margin acquisitions). That gets us CAD 163M in 2025 EBITDA or a 9x 2025 EV/EBITDA multiple.

Now, what would a reasonable public market participant pay for this business, given our above assumptions? CSU.TSX trades for ~20x NTM EBITDA, and Enghouse (another popular Canadian roll-up company) trades for ~15x NTM EBITDA. Let's assume a 15x market multiple on 2025 EBITDA. Doing that gets us CAD 2.45B in Enterprise Value. Add back the CAD 60M in net cash, and you get CAD 2.51B in shareholder value, or CAD 12.80/share. That's a ~65% upside from the current stock price.

There is a chance that 15x EBITDA is **far too low** for this business. But I'm hesitant to assign WELL a valuation greater than anything Mark Leonard runs.

We're content with waiting on the sidelines for now in hopes of lower market prices before entering a starter position. Ideally, we only want to invest in stocks with 100%+ upside *even* under conservative assumptions. Maybe WELL gets there.

Concluding Thoughts

WELL is an exciting business at the crossroads of Canada's transformation to a digital healthcare powerhouse. The company's led by a management team with ample skin in the game, and backed by one of the greatest investors of all time in Li Ka-Shing. WELL's acquisition strategy works so long as they continue to acquire great businesses generating substantial revenues at hefty EBITDA margins.

