Privcap/Report

Healthcare Game Change 2015

A collection of thought leadership, and of the people behind it, presented at Privcap's first full-day healthcare event

Privcap/Report

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About Privcap

Privcap is a digital media company that produces events and thought-leadership content for the global private capital markets. www.privcap.com

David Snow
CEO & Co-founder,
Privcap

Capturing an Ecosystem of Disruption

When advances in healthcare occur, the positive impact is felt by an increasingly large ecosystem of beneficiaries.

The most important are, of course, the patients, who receive quality care at a lower price. A new generation of fleet-footed and data-savvy providers also benefit, in that they win healthcare spend in a market hungry for innovation and consumer-driven business models.

And in many cases, the capital partners to these providers are being rewarded with high returns. Evidence of this was repeatedly presented onstage at Privcap's Healthcare Game Change event, which took place November 18 in New York.

The most talked-about session of the event saw Dr. Jay Parkinson give an overview of his groundbreaking startup, Sherpaa, which connects patients with doctors through text messaging. During a panel discussion of LPs later in the day, Frank McEvoy of New York State Common Retirement Fund said his pension was an investor in a venture capital fund that backed Sherpaa.

An innovative company that improves healthcare while also delivering returns to retirees is exactly what our society needs more of, and is the kind of story that Privcap hopes to tell again and again.

The content in this report tells many of those stories that were highlights of our conference, which drew more than 170 institutional investors, private equity managers, and healthcare innovators for conversations about the ways that capital and fresh ideas are revolutionizing the healthcare space.

In a market too often characterized by plodding, incremental change and shareholder value being extracted through financial engineering, we hope to see more in the way of smart capital meeting smart innovation. And you can be sure Privcap will be there to cover all the players and their best ideas.

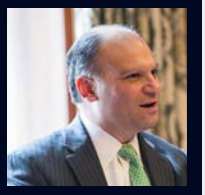
Enjoy the report,

David Snow
@SnowsNotes

In This Report

The Keys to Successful Partnerships With Doctors

John McKernan,
Vice President,
The Riverside
Company



Scott Perricelli,
Partner,
LLR Partners

Partnering with a physician or other medical professional on a deal is different than working with more traditional entrepreneurs. Experts from The Riverside Company and LLR Partners explain the dynamics that make for a successful deal.

Key Thoughts

Physicians Fear Losing Control of Medical Decisions
"The first thing every physician that we think about partnering with wants to know is, 'Who's going to control the clinical decisions? I don't want you suits coming in and telling me how to treat patients.'"
John McKernan, Riverside

Doctors Must Buy Into Value-Creation Plans
"The doctors we partner with are those who understand that they've gotten the business to a certain level, who see what we can bring as partners, and who are willing to partner with a private equity fund to help get a business to another level."
Scott Perricelli, LLR

Scale Is Critical
"Creating scale is critical. And when you can go into a provider organization and not only acquire similar providers but acquire to capture different pieces of the referral chain such that it's all in-house, it can create a tremendous amount of value."
John McKernan

Infrastructure Often Needs an Upgrade
"Compliance is key. That's driven both by putting good compliance professionals in, but also putting good technology in that can serve the business. [Also] recruiting a physician and mid-levels and nurses, credentialing them, and making sure we have a good medical director that can instill the provider culture."
Scott Perricelli

Partner With a Physician Who's Ready to Let Go
"We'll overpay for a business where we've got a physician-owner who says, 'I woke up one day and I'm running a $20M business with a couple of hundred employees, and I just want to get back to being a doctor. And what I want from you is to help me find a CEO.'"
Scott Perricelli

Why Data's at the Center of Healthcare Disruption

Blue Wolf Capital's Adam Blumenthal sat down with Mary Beth Kuderik from the UAW Retiree Medical Benefits Trust and Thomas Graham, M.D., from the Cleveland Clinic to discuss the kinds of innovation needed to propel healthcare forward from the points of view of a prominent payer and provider

Adam Blumenthal, Blue Wolf Capital: [Since] we're talking about innovation, let me ask each of you to ask the other one, if you could innovate something in the next two years that you really need now, what would it be?

Mary Beth Kuderik, UAW: What I would like the Cleveland Clinic to do is to apply all of the tools they have built and data they have collected around their focus on the patient toward nonprofits in a mission-driven way. Healthcare being very local, I can send people to Cleveland and the Cleveland members will

Mary Beth Kuderik,
CFO,
UAW

Dr. Thomas Graham,
Chief Innovation Officer,
Cleveland Clinic Innovations

Adam Blumenthal,
Co-founder & Managing Partner,
Blue Wolf Capital Partners

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benefit from that, but I'd like to see that be able to be done in other places.

[Later] we can get to how that request sounds to the Cleveland Clinic, but what would you like the patient and payers to do? How can they help innovate and make things better?

Dr. Thomas Graham, Cleveland Clinic: What we both have, yet we're at the very nascent stage of understanding how to manipulate, is data. And if we can find a way to innovate what we probably already have warehoused and what we're accruing at rates that are mind-boggling, could we find the bridge between the payer and provider that teaches us how to accept risk, teaches us how to accept costs and make care paths more efficient for different stratified populations?

So let me ask a question about how the business model of payers [and] providers relates to the capital markets. You have a customer and a vendor, and the customer is saying, "I want more." With that type of demand, in any other sector you'd say, "Who in this room wants to fund it?" But in healthcare, that's not the natural question. Why?

Graham: We're a little slow on the uptake, and more importantly, innovation in and of itself is a nonlinear, long-to-success, fraught-with-failure process. So we've almost self-limited, and that's where the strategies that we're now looking at [come in], through aggregation and partnership and collaboration, through trying to eschew the usual lament of "Everything we do is too early and too risky," we're trying to find the scale, the gravitas of what we do to attract the compelling magnet that is the capital markets.

Six years ago, the UAW Retiree Medical Benefits Trust, on behalf of its beneficiaries, was spending $4B a year. And we went out to the actuaries and said, "What does the future look like?" And they said, "By 2016, you're going to be spending $5B a year." We reduced the projected spend five years out by a billion dollars. So [Mary Beth], how did you do it?

Kuderik: The immediate things come through our pharmacy programs. So, for example, we had membership that had relatively unconstrained pharmacy protocols and formularies. Our model is not about restriction to any great degree, coming from who we are and what our values are. It's about creating affordability and access, but then driving the most economically valuable program for the folks with that. Another example would be driving, through medical care, better alignment in population health. It's not rocket science, as one would say, it's just having people understand where they need care, connecting them with physicians. We had a number of people who didn't have physicians or primary care.

Dr. Graham, you started by saying that if there's an area for innovation, it's sharing data. If you as a provider and Mary Beth as a payer/patient proxy could just share information, both of you could probably improve quality of life and lower costs. After all, healthy people actually have lower medical bills than sick people, right?

Graham: Mary Beth, [your] projected spend probably was counting on us just charging more [for the same services], right? That is important, because we have to find a way to deliver care more efficiently.

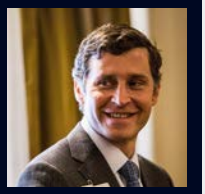
Cleveland Clinic's Dr. Thomas Graham answers a question.

Kuderik: The interesting concept here is that over time we don't expect, and don't desire, to just keep paying more for the same. Does it take price and cost to make the change happen and to compel the sharing of data, to compel the delivery of care in a more efficient manner, or to bring [together] all the manufacturing techniques into healthcare in terms of efficiency and effectiveness? It may. ■

Why It's Boom Times for Healthcare Deals

Three dealmakers said that healthcare companies of all sizes are looking for rich multiples, but also for PE sponsors who can add value and inject IT

Les Levinson, Co-chair, Transactional Healthcare Practice, Robinson + Cole



Andy Cavanna, Managing Director, Healthcare Co-head, Vestar Capital

Chris Harris, Managing Director, FFL

"We're always trying to find a company that's run by a team that wants a partner. We'll show up to the first meeting with experts who are affiliated with us. We try to demonstrate through the week, the month, the six-month period that we're getting to know this company and whether or not we really can add value. And if that trust isn't there, that's when we drop out of the process."

Andy Cavanna, Vestar Capital

Key Thoughts

Entrepreneurs Want to Sell
"Multiples are pretty good, and they've been pretty stable. If you go into the midmarket and you look at some of these entrepreneurial companies, [many have] been managing these companies for a long time. They don't really have a succession plan. The sun and the moon are kind of lining up, and it's a good time to get out."
Les Levinson, Robinson + Cole

Consolidation Opportunities Abound
"It's becoming harder to be an independent doctor today than it was 10, 15 years ago. A lot of physicians are trying to figure out what's going to be fee-for-service, what's going to be capitated and risk-based. They went to medical school thinking that they were going to see patients, and they're now spending their nights and weekends entering charts into an EHR. We're seeing, especially for the smaller physician offices, a real effort to consolidate. You see a lot of private equity interest in physician roll-ups at this point."
Chris Harris, FFL

Move Fast or Lose Good Deals
"Now, what typically happens is a banker pulls together materials and sends those materials to 10 people and offers up an early meeting. And out of those early meetings, more often than not, a company immediately goes into exclusivity. And so when you get that early look, you're going to be more aggressive on the valuation."
Andy Cavanna, Vestar Capital

Risks Are Abundant
"When we look at healthcare, there are a number of metrics we look at, but one is government reimbursement, and lower is generally better than higher. We also focus on commercial reimbursement risk and doctor risk. If it's doctor-owned, they're taking the earnings out today. And when you capitalize those earnings, what happens to the incentive for the doctor?"
Chris Harris

IT and Scale Are Creating New Opportunity
"Let's use one example—home care. That was a really manual business in terms of staffing. But if you look at what some of the companies with scale are building—they have multistate operations, they're building national call centers, they're using PDAs in all of the home care aides. You're driving a massive amount of efficiency, and that's where all the money's going to come from in the coming years."
Les Levinson

Dr. Joshua Bilenker, Loxo Oncology, Inc.

Precision **Medicine's Revolution**

Joshua Bilenker, a practicing physician who also happens to be a venture partner at Aisling Capital, discusses his investment in Loxo, and the nexus of medicine and investment

Privcap: What are the most exciting trends in oncology today?

Joshua Bilenker: I'd point you to two trends. One Loxo is firmly implanted in is targeted therapy. People hear the terms "precision medicine" or "personalized medicine," and the idea is to understand cancer at a genetic level individually, and then to pair that patient with the right drug specifically designed for that cancer. A second trend [concerns] immuno-oncology, which is the idea of taking the brakes off the human immune system so that the body can "re-recognize" the cancer as foreign, and use the immune system to attack it.

What did you learn about the healthcare business while you were an investor?

Bilenker: As an investor, when we think about the investment, we're basically conducting a trial in a pre-revenue company with a very high cash burn and a very complex regulatory space, and we're hoping that it works. In the life span of the investment, we're very unlikely to sell a product. What are we really creating with our risk capital? What we really create in the better companies is unequivocal clinical data—human data that shows that there's a health outcome that's been impacted.

What would you say to an institutional investor interested in the biotech space who wants to put capital to work in the smartest way?

Bilenker: The great products, the great therapies, are well understood by everybody. Aligning with proven management teams that have created value, have created products that get approved—that's obviously an important box to check.

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What is life like for you as a publicly traded company, and what do you predict on the horizon?

Bilenker: The capital markets have been very interested in taking more risk. Depending on how you do the math, there are probably about 200 companies now that didn't exist in the public markets before. Some of them probably went too early; many of them are not going to work. There's a lot of opportunity within the public markets.

Would many of these biotech companies have an easier life as privately held companies?

Bilenker: The path to liquidity for an institutional investor, whether venture or private equity, is really twofold in biotech. One is a trade sale to a strategic partner, a big pharma, a big biotech who needs that technology for their pipeline or an IPO.

When the IPO window shuts down, there's one path. All the power shifts to the business-development groups at 20 or 30 large pharma, large biotechs, where those teams seem to be in a revolving door on a two-to-three-year cycle. They can't give you consistent advice as a company about what you need to show to be an attractive acquisition candidate. One thing we've seen in the financing of private companies is there's much broader syndication. There used to be this orderly handoff between series A, B, and C investors, every subsequent round paying a little more than the prior round. ■

> "What we really create in the better companies is unequivocal clinical data—human data that show that there's a health outcome that's been impacted."
>
> –Joshua Bilenker, Loxo Oncology, Inc.

Bilenker answers a question from Privcap's David Snow

Questions from the Audience

What are the trends in early or expedited regulatory approval?

Bilenker: The industry has made that job easier, because the therapies that are being filed now for commercial sale—for approval—are much more convincing than they were five-plus years ago. You're seeing about a third of all new drug approvals are coming in the oncology division, and there's a reason [for that]. It's just where we've invested in the primary research for decades. Fortunately, the FDA has really helped innovation here. There are other pockets of the FDA that have been a little more backward-looking, more conservative.

What is the value proposition between immunotherapy and a targeted approach?

Bilenker: At Loxo, we realized that for 100 years pathologists have been describing cancers based on what they see under the microscope. Targeted genetic testing in a multiplex way—not a gene-by-gene, one-question-at-a-time way—really has broken this open. The more forward-looking cancer centers have said this is so important scientifically, we're just going to do it.

The immunotherapy trend is a little touchier, because these probably aren't chronic therapies. These are more episodic. Gene therapy, that's bespoke medicine at a cellular level, where you take cells out of a patient. You modify them and put them back, whether it's in their eyes to [treat] blindness or in their bone marrow to overcome refractory leukemia. The cost of goods of running a business like that are very high.

Data as a Healthcare Disrupter

Mark Harris,
Jenner & Block

How to handle, manage, protect, and store data in the age of the Affordable Healthcare Act has driven consolidation among healthcare technology companies and has become one of the biggest disrupters in the industry, says Mark Harris of Jenner & Block

One of the biggest drivers of mergers and acquisitions in the nearly $3T U.S. healthcare industry is the way companies are dealing with the extraordinary amounts of data containing sensitive and federally protected patient information.

"Companies have accumulated a tremendous amount of data over the last couple of years," says Mark Harris, chairman and managing director of Jenner & Block's private equity group. "They're trying to figure out new and better ways to use that data, to store it, to transmit it, and to allow clinicians to develop patient-care strategies based on the data that they have."

The boom in data has been a boom for private equity. One of the largest transactions in the healthcare industry in 2015 was IBM's $1B acquisition of Merge Healthcare—a leading medical imaging company, processing billions of images such as MRIs, CT scans, and X-rays. Merge would be an add-on to its Watson Health Unit, according to IBM.

The acquisition is just another example of the kind of consolidation of technology-based companies that is going on in the healthcare sector.

"There are plenty of opportunities to aggregate interesting companies and make them attractive to the private equity market," says Harris.

One of the ways to make those companies more attractive is by facilitating different healthcare providers to be able to share patient data among specialists and facilities so that doctors and technicians are looking at the same records. Some examples could be the use of cloud storage solutions, cybersecurity best practices, and workflow solutions that streamline the supply chain, Harris says.

"There are economies of scale that companies can use to be more efficient and bring the cost of healthcare down," he explains. "Being able to share that information is important so patients aren't being X-rayed multiple times for the same injury, or conflicting drugs are not prescribed, for instance."

Harris says one of the challenges of doing due diligence is drilling down into who owns the rights to certain data and how that data can be used going forward. "It's important that the lawyers get in there right away and understand those rights," he says. "Those transactions are all negotiated separately, and they're not necessarily uniform." ■

"Being able to share that information is important, so patients aren't being X-rayed multiple times for the same injury, or conflicting drugs are not prescribed, for instance."

– Mark Harris, Jenner & Block

The 5 Things You Need to Know About Early Stage Healthcare

Investing in early stage healthcare companies is not for the faint of heart. Three experts explain how to navigate this complicated market without losing nerve.

David Chase,
Founder,
Rosetium

Isaac Manke,
Private Equity Partner,
New Leaf Venture Partners

Nancy Brown,
Venture Partner,
Oak HC/FT

Key Thoughts

Public Market Exits Are Uncertain, But Hold Potential
"If you pick your spots, there's tremendous opportunity, and I think over time the IPO market will become clearer."
David Chase, Rosetium

IPO Criteria Have Been Reset
"Biotech companies have gone public at average pre-money valuations of $250M, raising about $100M."
Isaac Manke, New Leaf Venture Partners

Existing Investors Crowd Out New Money
"In the tech space, there's less opportunity to bring in new investors, because the investors who are there want to double down."
Nancy Brown, Oak HC/FT

Investors Need Knowledge and Flexibility
"You have to strike this balance of understanding the idiosyncrasies of healthcare without being shackled by them."
David Chase

Needs of Millennials Will Drive Healthcare Deals
"In 10 years, they're going to be 75 percent of the workforce, and as a cohort [they] are the least healthy in the last 100 years. They're having to engage with the system a lot earlier than people just 10 or 20 years earlier."
David Chase

Playing the Healthcare Evolution

Chris Gordon,
Managing Director,
Bain Capital

Senior executives from TPG Capital, Bain Capital, APAX Partners, and The Carlyle Group talk about the state of healthcare dealmaking. Are the opportunities too good to be true?

Todd Sisitsky,
Partner,
TPG Capital

Buddy Gumina,
Partner,
APAX Partners

Angela Humphreys, Bass Berry: Why are you bullish on being a healthcare investor?

Chris Gordon, Bain Capital: The private equity business model is the best fit for dynamic circumstances. Steady-as-you-go growth companies or moderate-growth companies might be great investments, but they're hard to create differential returns around.

Buddy Gumina, APAX Partners: It is always more of an evolution than a revolution in healthcare. Bigger businesses [are realizing] that business as usual is not going to generate the usual profits.

Will McMullan,
Principal, U.S. Buyout,
The Carlyle Group

Angela Humphreys,
Chair, Healthcare Practice Group,
Bass, Berry & Sims PLC

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Todd Sisitsky, TPG Capital: More has changed in the last three to five years in healthcare than the previous few decades. And that creates an interesting opportunity for private equity.

McMullan, The Carlyle Group: The biggest problems facing this sector, as well as this country, is that healthcare is too big and it's growing too rapidly. And from an investment perspective, that's obviously attractive. But there are warning signs, as it's in the sights of the political system, the regulatory system, and the general population.

How do you develop your investment theses, and then how do you put them to work?

Sisitsky: Thinking about what we're all trying to accomplish and then proactively identifying the segments that might fit into that well is a big part of what we do. But ultimately, until you get out there and you really spend time in this space and you try to meet every CEO and you try to attend the industry conferences and really understand the flows and how the power dynamics are evolving, you don't really know.

Gumina: One of our core themes is efficiency—companies, products, devices, services, technology—that takes cost out of the system. Another theme for us is globalization. People think about healthcare as a very local business—and in some cases, it is. In other cases, there are opportunities to expand a business into new markets.

With all the disruption that we're seeing from smaller companies, how can big dollars from private equity be effectively deployed in the healthcare space?

> "More has changed in the last three to five years in healthcare than in the previous few decades."
>
> –Todd Sisitsky, TPG Capital

Gordon: The hardest question is figuring out which ones have an ability to transition their business model in a way that either has upside or at least not too much downside...without having too much risk of that current profit pool as the system changes.

McMullan: Healthcare is much more of an evolution than a revolution story. Can we start with this and add on and layer in the additional capabilities that they need in order to evolve with the market and maintain their leadership position?

How far along are we in terms of cost containment, and what does the ability to bend the cost curve mean for you as investors?

Sisitsky: I don't know that it's so much cost containment as it is some form of consumerism—people becoming much more aware of healthcare spend as they have to absorb more of it themselves and act a little bit more like consumers.

Gumina: We're still in the early innings, but I also have a view that the ACOs and quality-based reimbursement is going to take a lot longer than people think. You're going to have a lot of roadkill along the way.

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Gordon: I would say it's pretty early, but I could actually imagine an acceleration in the pace. We're seeing that when people are given that choice, they tend to gravitate to the lower-cost plan, but they're OK with it because it was a choice that they made.

Will and Todd, can you talk about reimbursement risk related to your investments? How do you understand it, and how much risk are you willing to take in today's environment?

"People think about healthcare as a very local business—and in some cases, it is. In other cases, there are opportunities to expand a business into new markets."

–Buddy Gumina, APAX Partners

McMullen: [You can] get a sense of what the near term, and maybe even the medium term, holds as you look at various reimbursement models, but it's really hard to look out beyond that with any level of certainty. It's really hard to say, "In six years, this is what the reimbursement trend for a given industry is going to be."

Sisitsky: Whether it is reimbursement or it is commercial pressure, there is a general effort to accommodate higher volumes at a lower price. ■

Questions from the Audience

What's most important in terms of measuring care quality?

McMullan: Outcomes are clearly something that's important. Are the patients getting better at the fastest rate? Are they getting fully rehabilitated as part of the care plan that you're providing?

How would you assess your current investments and future investments if there are major changes to the ACA?

Gordon: There's always an economic impact of changes in regulations. But often, within some reasonable set of outcomes, you can make a judgment around the risk return you're taking. There's another kind of risk which is really more an existential risk. That is, if you're looking at a business model that relies narrowly around the way the current regulations are structured, as long as those don't change, you'll be fine—but if they do, the elephant can roll over and kill the fly.

Lunch Keynote

For Healthcare Savings, a Push to Cut Out the Middleman

Sherpaa co-founder and chief medical officer Dr. Jay Parkinson explains that with commonsense data gathering, his company hopes to revolutionize consumer healthcare

What if you could easily avoid an unnecessary visit to your primary care physician and skip to seeing the specialist you needed all along?

Dr. Jay Parkinson, founder the online startup called Sherpaa, is working hard to make that a reality.

Parkinson says Sherpaa, founded in 2012 with headquarters in New York City, is a platform that mixes electronic medical records, customer relationship management, and customer help desk. Its staff of doctors works with roughly 150 businesses in New York, Los Angeles, San Francisco, and Chicago. Its model is right from the PE operating playbook—wringing value from a broken system through operational efficiencies.

The premise of the Sherpaa service is simple: Before visiting his or her primary care doctor, a patient contacts Sherpaa. The patient answers a questionnaire in a secure online system, and a doctor reviews the information and communicates with the patient on the platform. The patient can then be referred to an appropriate provider for an in-person visit, or in many cases the Sherpaa doctor can diagnose and treat the patient virtually and avoid a costly visit altogether.

"We will take a history, we'll figure things out, and we'll see if we can diagnose and treat it," Parkinson says. "If we can, great. If not, we intelligently refer them."

Parkinson's group found that nearly three-quarters of ailments do not require office visits.

Sherpaa's corporate clients pay the company a monthly per-user fee for the service, so the online consultations aren't billed to insurance. The idea is that by reducing the number of in-person doctor visits, the ultimate savings in insurance premiums will more than offset the cost of Sherpaa.

Parkinson says that some of Sherpaa's self-insured clients have seen a 50 percent decrease in raw number of claims.

"You can think of us as almost like a smart filter," says Parkinson. "It is a complete redesign of how and why people go to the doctor." ■

"You can think of us as almost like a smart filter. It is a complete redesign of how and why people go to the doctor."

–Dr. Jay Parkinson, Sherpaa

Les Levinson, Robinson+Cole

What's *Motivating* Healthcare Sales to PE?

Consolidation has ramped up for some subsectors of the healthcare space, and the number of companies deciding to sell to private equity players has also increased. Les Levinson, co-chair of the transactional healthcare practice at Robinson+Cole, discusses why these changes are happening, and why the post-acute space has become more open to PE buyers.

Privcap: What scenarios are motivating sellers now versus a few years ago?

Les Levinson, Robinson+Cole: We have a pretty favorable capital structure environment, so money is reasonably available, interest rates continue to be very low, [and] that attracts deal-making activity. We certainly have consolidation again, as exhibited by what we saw in the insurance industry, but you're also seeing a tremendous amount of consolidation throughout the services sector.

Whether in the hospital market, the physician market, the post-acute market, or homecare and hospice, you have sellers at different levels who feel like now might be the time to sell rather than making significant capital expenditures in their businesses. Partnering with a private equity firm, a strategic or a quasi-strategic seems like a viable alternative.

Do you see consolidation continuing?

Levinson: There is only so much consolidation that one can have in the market. If you take the large insurance company sector, when you have five, six or 10 players, there is a limit to consolidation.

How is post-acute care different from other subsectors?

Levinson: The industry and that subsector is much more fragmented than, let's say, a hospital market where you may have a dominant player in a particular market or several in a regional area. Those businesses tend to be more mid-market, which lends itself more to a roll-up, or a consolidation strategy. Again, capital is plentiful. You have a more willing seller environment, which you didn't have two or three years ago.

When that reimbursement cliff looked more severe, sellers were looking at two, three kinds of multiples, and those weren't getting people very attracted to doing a transaction. You have a climate that is more hospitable on the sell side; you have a climate that's hospitable on the buy side.

Why are some owners of post-acute facilities now willing to sell to PE?

Levinson: Economics are a large part. We began to counsel our clients as early as 2010 to do whatever they could to get a seat at the table to have conversations with the provider and payer communities that they operate in. This is because, at some point, that dance floor is going to become filled and there aren't going to be any more seats at the table.

Technology has changed a lot of the ways that these companies operate, such as the ability to capture data and to manage it. To use it in a way that you can be a participant in a risk-sharing consortium is much different than it used to be. Sometimes there's just a right time to get out.

Now, a lot of the folks that we might refer to as "mom and pops" have substantial businesses, but a lot of them have started those businesses. They may have come from a clinical background, so they're the owner-operator; they've been in it for 30 years. They may not have a lot of experience in M&A or in growing their business beyond organically, so coming in with somebody who's a deal professional could be very appealing to those folks. ■

What You Need to Know Now: Pharma

A panel of experts discuss how to make money in a business where innovation and technology are key

Adam Dolder, Managing Director, Great Point Partners

Daniel Agroskin, Managing Director, JLL Partners

Andy Jenkins, Partner, Transaction Advisory Services, RSM US LLP

Key Thoughts

Personalized Medicine Is Here
"You think about personalized medicine—it's a hot topic, a buzzword, but it's true today. The ability to target a particular patient with a particular therapy is real."
Adam Dolder, Great Point Partners

Clinical Research Organizations Are at Risk
"Everybody talks around the interest in clinical research organizations [CROs] on the private equity side. Our view of it is that that sector has really consolidated and it will change going forward, because technology will have a pretty pronounced effect on how clinical trials are done. And it's going to hurt the CROs."
Daniel Agroskin, JLL

Third World Becomes First World
"Third World countries will become First World countries at some point in time, [wanting] more access to care, more access to therapies. Additionally, [there will be] the rise of China as both a manufacturer, researcher, etc., also with more disposable income."
Adam Dolder

Pharma Companies Look to Outsource Services
"Large pharma, in particular, have made a decision what's core and what's non-core to them.... Now they're really moving to very focused commercialization organizations and try[ing] to identify molecules.... By definition, they're virtual companies, and they need outsource service providers like the ones [we] are investing in."
Daniel Agroskin

Steer Clear of Companies With Regulatory Issues
"The FDA has been always very strict in enforcing the guidelines. They are certainly taking a pound of flesh now, much more so than they ever have."
Daniel Agroskin

Frank McEvoy,
Investment Officer,
NYS Common Retirement Fund

Meena Lakshman,
Director of Strategy & Research for Investments,
Helmsley Charitable Trust

Brian Gildea,
Managing Director,
Hamilton Lane

What LPs Want From Healthcare

Representatives from Hamilton Lane, NYSCRF, and the Helmsley Charitable Trust discuss "generalists vs. specialists," investing in technological disruptors, and how they vet GP relationships.

David Snow, Privcap: Where does healthcare fit within the private equity portfolio?

Brian Gildea, Hamilton Lane: When we look in their portfolios, we see that healthcare is about 12 percent of the U.S. private equity industry overall, compared to about 8 percent of the S&P. The risk of loss in healthcare investments in the private equity space overall has been lower than a number of other industries. Importantly, it has outperformed the public-market indices.

Frank, how does NY Common evaluate its PE partners?

Frank McEvoy, NYS Common Retirement Fund: We look for experienced teams with top-quartile track records. Their sector-specific experience is a value add in our investment decision, but it's not necessarily the determining factor.

How big is your allocation to private equity?

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McEvoy: We have an allocation of between 8 percent and 10 percent of the value of the overall fund. On an annual basis, we need to get between $4B and $6B out the door. Our minimum allocation is about $100M.

Brian, as someone who advises in investing institutions, have you seen a greater desire to go with specialist fund managers?

Gildea: You definitely see a trend of more expertise, whether the expertise happens from a generalist fund with teams that are vertically specialized at the large end. But on the smaller end is where you really see the specialist managers.

Meena, how do you approach healthcare investments?

Lakshman: We go with the top-tier managers, and it's not easy to get the capacity that we would like in their funds. We tend to get smaller capacities because of our size and because we are a new fund.

Do technology-focused disruptors tend to be a smaller investment play because you're backing smaller fleet-footed companies?

"We look at the track record and the composition of the GP partners. [Knowing] their background helps a lot."

–Meena Lakshman, Helmsley Charitable Trust

"The risk of loss in healthcare investments in the private equity space overall has been lower than a number of other industries. Importantly, it has outperformed the public-market indices."

–Brian Gildea, Hamilton Lane

Lakshman: Yes. A lot of the venture capital firms that have done very well in the tech space are now diversifying into biohealth. And the checks that they are writing are in the $1M to $7M range.

McEvoy: Ten years ago, it was a million dollars to buy into a company. Nowadays it's $250,000, and you run it on a milestone basis.

How do you vet potential GP partners?

Gildea: We have an investment team of 80 people who spend all of their time doing just that. It very much comes down to getting information on the historical track record and performance and specific value creation.

Lakshman: We look at the track record and the composition of the GP partners. [Knowing] their background helps a lot.

Have you seen successful LP co-investing in healthcare, despite the industry's complexity?

Gildea: We've done a lot of co-investing in the healthcare sector, and we manage some money to do that directly ourselves, not on behalf of our clients.

Lakshman and McEvoy address the audience.

We're in a fortunate position in that we're a big provider of capital to the general-partner universe, and we have dedicated resources to build and execute on the co-investment.

Frank, what is the NYS Common approach to co-investment?

McEvoy: We have a large co-investment vehicle that has just come online in the past couple of months. The first

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Hamilton Lane's Gildea and NYS Common's McEvoy listen as Helmsley Charitable's Lakshman answers a question.

"When industries are being disrupted, whether it's through the ACA or just the desire to control healthcare costs in an aging population, that environment is generally good for private equity."

–Frank McEvoy,
NYS Common Retirement Fund

few deals that we have seen have not been in healthcare.

Are you and are your clients interested in healthcare in the emerging markets?

Gildea: Obviously there's huge growth there, driven by economies that have increasing wealth and increasing demand for health services. Understanding the regulatory frameworks in those environments and whether you can make money on the investments is important.

Lakshman: The growth rate of the aging population in emerging markets is higher, and as you get wealthier and as you age faster, your healthcare expenditure as a percentage of your total expenses goes up.

Frank, does your fund's size pose a challenge in the emerging markets?

McEvoy: It is a problem. Nonetheless, in the past couple of years, we've recognized that there are tremendous opportunities there.

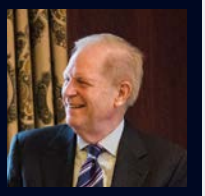
How bullish do you feel about the opportunity to invest in U.S. healthcare going forward?

Lakshman: Our firm is quite bullish on U.S. healthcare. There is a lot of money flowing in, [and] a lot of entrepreneurs are getting into the space. Not everybody will be standing 10 years down the line, but I think it's a very interesting space.

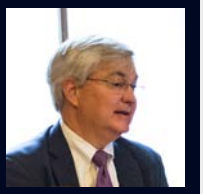
McEvoy: When industries are being disrupted, whether it's through the ACA or just the desire to control healthcare costs in an aging population, that environment is generally good for private equity. Change is good. Disruption is good. ■

The Big Takeaways on Big Data

Data is incredibly important for investing in diagnostic tools and devices, but how do you pull it all together?



P. Sherrill Neff,
Founding Partner,
Quaker Partners



Mark Harris,
Partner,
Jenner & Block

Ben Daverman,
Principal,
GTCR

Key Thoughts

Data Silos Remain a Challenge
"We're in the very early stages of identifying, unlocking, and making use of the data that can really drive cost and the quality of healthcare."
P. Sherrill Neff, Quaker Partners

But You Don't Need All of the Data to Make Meaningful Decisions
"When you look for data, you look for those choke points. You can draw insights from a large sample. The fact that you don't have 100 percent—you have 60 percent, but it's multiples of what's available now—is still very meaningful."
Mark Harris, Jenner & Block

Investors Need Not Be on the "Bleeding Edge"
"If people are willing to bet on future technologies, oftentimes they are undervaluing today's technologies. That's where,hopefully, we can find good investment opportunities."
Ben Daverman, GTCR

The Healthcare Information Industry is a Tough Nut to Crack
"I have been around healthcare information long enough to know that I don't know enough about it to figure out how to make it work as an investment, so I am more than happy to watch other people do it."
P. Sherrill Neff

Strategics Can Be Private Equity's Friend
"If you can get deals done, these same strategics that you're potentially competing with will be interested again if you're growing these businesses."
Ben Daverman

DeVon Wiens,
Moss Adams LLP

Monetizing Healthcare Real Estate

Private equity has started to dabble in the real estate industry, seeing value in deals involving hospitals and the surrounding property

Investing in real estate in the medical space remains somewhat unusual for private equity firms, which have tended to focus on acquisitions of healthcare companies.

Some private equity funds have invested in long-term care and acute care, but it's "relatively new ground for private equity to go into the [real estate] industry," says DeVon Wiens, a CPA and national practice leader at Moss Adams LLP.

Moss Adams, a public accounting and business consulting firm, will advise on the buy-sell side of a healthcare investment, helping clients get a fair deal. Or the firm will critique a business office—of either a physician or laboratory—and look at the efficiency of how claims are processed, cash is collected, or coding is done. It has another group on the business strategy side that deals strictly with changes wrought by the Affordable Care Act (ACA).

Wiens primarily provides assurance services to clients at Moss Adams, but also gets involved on the transaction side. "I'm not an investment banker, but I know enough when it's time to bring an investment banker in," he says.

Moss Adams recently worked with several clients who obtained real estate financing from a healthcare real estate investment trust (REIT) that provides healthcare and hospital operators access to capital for facility improvements, technology upgrades, staff additions, and new construction through the long-term lease of its real estate assets. Wiens says Moss Adams got involved with that REIT because the firm has a significant number of for-profit hospital clients based in Southern California, out of which he personally works on four.

Many middle-market private equity firms have shied away from hospital ventures due to the capital needed to purchase the underlying real estate. Instead, they will bring in a REIT as a partner, to own the real estate and invest in the hospital's operating company. "There's a little bit of a subtle change in the last 24 months as to how capital markets are working in the space," Wiens says.

Some tax-exempt inner-city hospitals have been struggling to stay afloat, as they serve patients who tend to need more care and may be uninsured or underinsured. Many of these hospital organizations have the real estate surrounding the hospital for medical office space and ancillary services. As government-sponsored reimbursement programs continue to reduce returns, these organizations are in need of opportunities to increase cash flows. That surrounding real estate is one source, but most of these organizations don't know how to monetize the properties and extract their value.

"Many of these hospitals are prime real estate that turns into something other than a hospital," Wiens says. He gives examples of hospital properties transforming for use as specialty hospitals or other healthcare services, and even housing or churches. ■

Where the Smart Money Is Investing

Three big-time PE investors from BlackRock, The Abraaj Group, and Siguler Guff talk about where and how to find the best opportunities in pharma, hospitals, and information technology

Privcap: Is there opportunity in the emerging markets for pharma?

Praneet Singh, Siguler Guff: Broadly speaking, yes.. What we like about pharma are the return-capital characteristic—the ability for these businesses to build scale without dependence on the doctors, to some extent.

A lot of the opportunity is in building hospitals. Where are you seeing that?

Khawar Mann, Abraaj Group: We are extremely focused on looking at specialty hospital clinics—dialysis, diabetes, etc.—across Africa and South Asia. You really have to look at the growth characteristics of these markets. There are substantial growth opportunities, but you really have to have the operating skills to navigate them.

Matthew, in what region does BlackRock see the most opportunity for healthcare?

Matthew Roberts, BlackRock: We've mainly focused on Asia, in particular

Khawar Mann,
Managing Director,
The Abraaj Group

Matthew Roberts,
Vice President,
BlackRock

Praneet Singh,
Managing Director,
Siguler Guff

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China and India, [where] we've seen a number of opportunities on the pharmaceutical side, as well as in most other subsectors in healthcare.

Praneet, this year alone has seen $30B of proposed take-private transactions in China. Why do you think the entrepreneurs are looking towards private equity instead of public markets?

Singh: Healthcare delivery, diagnostics, and hospitals have been a very fragmented space and will continue to be so. Therefore, the average size of these businesses is actually really small, [and it is] tough to take them public or even get bank credit.

Matthew, you don't look at Latin America too much. Why is that?

Roberts: We do mainly co-invest[ments] or direct investments, so we do get to see a wide range of what's going on in the industry, including emerging markets. As for the deal flow, especially in Latin America and Brazil and Argentina and Chile, we haven't seen what we would have liked to see.

"You need to have local smarts. You need to know local regulations. You need to be locally connected [and] really understand the right people to back."

–Khawar Mann, Abraaj Group

Khawar, how do you navigate the minefield of different cultures?

Mann: Every country and every city is different. You need to have local smarts. You need to know local regulations. You need to be locally connected [and] really understand the right people to back.

What's the typical lifetime of an investment for each of you?

Singh: We would normally put money [to work] for five to seven years. A seven-year time frame is reasonable. For pharmaceuticals, diagnostics, it could be an even shorter time frame in terms of getting to a certain scale for exit.

Roberts: Most of our emerging-market deals, the ones we realized, have been on a fairly quick time frame. Part of that is because the thesis isn't to go

Abraaj's Khawar Mann listens to a question from the moderator.

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Panelists Mann, Roberts, and Singh.

> "We would normally put money [to work] for five to seven years. For pharmaceuticals, diagnostics, it could be an even shorter time frame in terms of getting to a certain scale for exit."
>
> –Praneet Singh, Siguler Guff

in there, change management teams, change operations, do these long-term projects. It's typically a much more growth-oriented thesis. In our case, it's tended to be three to five years instead of the standard five to seven.

Mann: We want to make high ROI for our investors and for ourselves and have a big impact, so that means we're looking at five to six years. ■

Questions from the Audience

Have you seen, or do you predict, that a device or a technique innovated in the emerging markets could actually be successful in the West?

Singh: I haven't. There is a whole family of devices that are portable, like ultrasounds and portable ECG monitors. [There's] nothing rocket science about the actual device, to be honest, but the overall costs that some of the Chinese manufacturers are able to manage, they could disrupt some of the markets—even in the developed markets.

Roberts: I know India, at least from a government perspective, has put a large focus on med tech. As a result, you will see some more devices coming out of it in the future.

What kind of multiples have you seen in your portfolio?

Singh: If you remove the hospital business, the diagnostic business has a very high return [of] capital. There's a lot of buying interest for people to consolidate and improve the quality of a small-to-midsize business. So in fact, most of our exits tend to be selling to a larger private equity fund, so we do smaller deals, and we get fairly good valuations. China has been the best for us, but mainly driven by currency. We made 4x-plus on our diagnostic deal that we exited.

Why a Hospital's Pain Is PE's Gain

Two experts describe an investment landscape in which patients are opting for closer, cheaper care

Dr. Richard Becker,
CEO,
New Found Health

Eric Nicholson,
Partner,
Moss Adams

Key Takeaways

People, Not Policy, Are Driving Change
"The Affordable Care Act…enrolled more folks and provides some access to people who didn't have it. But whether [the ACA] is there or not, the [healthcare] train has left the station, and it's moving. People want healthcare when they want it, how they want it."
Dr. Richard Becker, New Found Health

Cost Efficiency is Make or Break
"This is the first year where, apples-to-apples, if we do the same amount of service, we're going to get paid less. So whether I'm a fee-for-service provider or I'm going to start to take risk, it's all about cost. It's all about making that episode of care cheaper, because that's the only way I'm going to improve or maintain my profitability."
Eric Nicholson, Moss Adams

Low-income Areas Are Rife with Opportunity
"We went into low-income areas—Medicaid areas—because when we drove around, the only urgent care you see is cigarettes-and-beer one-stop shopping. We thought, wouldn't it be interesting to see if people who are living in these neighborhoods would actually use high-quality urgent care? And guess what? They do."
Dr. Richard Becker

Big Group Buyers Are Flexing Their Muscles
"Intel has said, 'Do you want to be the low-cost provider or not? We'll tell our 50,000 employees they can go to your facility for no co-pay. If you want to be the next one, we'll tell them they come to your facility for a $2,000 co-pay. And if you don't want to play, well, then, you're the $5,000 co-pay, which means literally you'll get two visits.'"
Eric Nicholson

Consumers Want to be Treated "Anywhere But the Hospital"
"The mantra now is 'anywhere but the hospital.' It's a big hike to get to an emergency room. If you do need a hospital bed, maybe we can set up a hospital bed in your home. We looked at a company recently that's coming online to do just that—set up a hospital bed in your home with a telemedicine unit linked to a physician and a nurse that's staffed in your home."
Dr. Richard Becker

Investing in a Segmented Healthcare Market

Tammy Hill,
Partner,
RSM US LLP

As the healthcare sector strays from the traditional hospital setting, private equity has an edge in finding deals amid high valuations, says RSM's Tammy Hill

Healthcare is a highly segmented sector, and to private equity, that translates into an opportunity—if you're willing to do some homework.

The way private equity firms deal with companies after the acquisition lends itself to this segmentation in healthcare, says Tammy Hill, a partner in transaction advisory services at RSM. "They will partner with operating partners who are very knowledgeable in whatever space they're thinking about investing in. Private equity investors, in general, like situations where the more you know, the better your chances of success are."

There are some healthcare sectors that exist today that were much less prevalent five or 10 years ago, says Hill, partly because healthcare services have moved farther away from the big hospital setting. The boom in urgent care storefronts and clinics that is happening now was not nearly as common even five years ago. "In many cases, people's first thought now, rather than going to a doctor or maybe even an emergency room, is to go to an urgent care center," she says. In some cases, for certain illnesses or injuries, the urgent care clinics are less expensive, it's easier to get in to see a doctor, and the reputation and quality of care has improved. "It's just so much more efficient than some of the more traditional settings for healthcare services," Hill adds.

The increased segmentation of healthcare companies has led to high demand from private equity investors and therefore high valuations. In some cases, this immediately leads to PE firms bowing out from the bidding process as the prices go up. But one way they can work around the high valuations is by harnessing the value of their operating partners and their expertise. "They will begin discussions with a company before the seller goes to market with a broader sales effort through an investment bank," Hill says. "Maybe their operating partners have contacts. They see a good fit." If they can make their case to the seller, if there's a healthy transaction value, and if the valuation is right, going this route can result in a more streamlined process for the seller as well.

Hill says that doing the homework on a transaction up front is important, as well as making a solid bid and executing a quick close. "We do a large number of sell-side diligence projects now to help the sellers," says Hill. "That gets a lot of the detailed homework out of the way on the financial and operational diligence. And then when the seller goes to the market, they can say, 'We have already done a lot of the necessary work and, as a result, the buyer's process should go smoothly and take less time.'" ■

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