Privcap/Report

Q4 2016

Privcap Game Change:

# HEALTHCARE 2016

*A recap of Privcap's second-annual healthcare conference*

# **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. Privcap offers communications services to market participants.

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**David Snow**
Co-founder & CEO,
Privcap

## A Radical Change

Rarely has there been an industry so ripe for disruption as healthcare.

That the terms "disrupt" and "revolutionize" were overheard so frequently at Privcap Game Change: Healthcare 2016 was in itself notable—typically, words like "inertia" are applied to the U.S. healthcare system. And yet, as was pointed out frequently onstage and among the delegates, there are many indicators that a tipping point is about to be reached, after which few legacy business models in healthcare will be left unchallenged.

One driver of change will be the millennial generation, which expects its services to be convenient and to be delivered digitally, and is open to new brands and new formats for receiving healthcare. That insistence on digital orientation, mixed with the ever-increasing costs of care, is driving a revolution in healthcare delivered outside of the traditional facilities.

One panelist, Dave Chase, an author and advisor to healthcare investors, warned legacy players to take a lesson from Kodak, the photographic film company trying to reinvent itself. The company's executives knew digital photography was on the rise, but didn't anticipate how quickly use of this technology would accelerate, until demand for traditional Kodak products had collapsed, along with the venerable brand itself.

We all know that digitally facilitated care is on the rise, but many underestimate how quickly patients' preferences will change once they discover better and cheaper options. Most of the investors and entrepreneurs in the room at Game Change: Healthcare have made a bet that these changes will be more radical than gradual.

Enjoy the recap,

David Snow
@SnowsNotes

# In This Report

# What You Missed at

## Privcap Game Change:

# HEALTHCARE 2016

### A roundup of notable thoughts from the event's panels

Our second-annual healthcare conference, Game Change: Healthcare, was a great success. The event, held November 17th at the New York Marriott Downtown, drew nearly 200 delegates, including general partners, institutional investors, fund-of-funds, healthcare companies, and others.

The day featured a series of panels, keynote interviews, and breakout sessions to discuss how private equity and venture capital players are responding to new healthcare technology, finding new uses for data, and gauging impacts from potential changes to the Affordable Care Act.

Among the topics: what impact data science is having on treatment and outcomes; how new technologies, business models, and pooled resources have transformed PE portfolio companies; why limited partners are keen to co-invest in healthcare deals; and a "smackdown" discussion on the differences—and similarities—of millennial and baby boomer generations, and how they view healthcare differently.

At the conclusion of the event, it was clear that those in the healthcare field—or those investing in it—need to keep up with new technologies and business models, or contribute to a staid perception of the industry.

**Here's what some of the expert panelists had to say:**

### From the panel **"The Big Data Revolution"**

"The ability to use data isn't just about cool analytics ... It's how do you integrate it into the healthcare system?"

– **John Sculley**, chairman of the board and chief marketing officer for RxAdvance.

"Never underestimate the inertia within the healthcare system. People are very attached to tradition in healthcare."

– **Lisa Latts**, deputy chief health officer and lead healthcare quality officer at IBM Watson Health.

"We are inertia. We are so behind the eight ball on telehealth."

– **Prabhjot Singh**, M.D., chair of the department of health system design and global health at Mount Sinai Health System, reacting to Latts' comment.

"Huge data streams coming in from patients can be extremely useful."

– **Sean O'Sullivan**, a managing partner at SOSV, a VC accelerator fund investing in tech startups.

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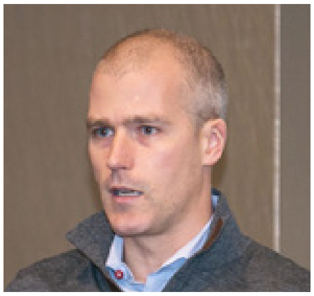
## From the panel **"Old Business, New Models"**



"The administrative savings for hospitals and healthcare systems are dramatic."

– **Hunter Philbrick**, a managing director at Hellman & Friedman, on moving medical records to a digital system.

"You're not going to see us get to total transparency."

– **Ram Jagannath**, a principal with the U.S. Buyout group at The Carlyle Group, on having a transparent healthcare data system.

"There's a lot of low-hanging fruit for health plans at the moment."

– **Robbert Vorhoff**, a managing director at General Atlantic, on where to find areas to cut healthcare spend.

"It's extremely competitive in both GPs and strategics."

– **Angela Humphreys**, chair of the healthcare practice at Bass, Berry & Sims, after talking about a deal that went through several rounds of bids.

## From the panel **"Flexible LP Capital"**

"We're seeing a large appetite for co-investments. But we're seeing few execute on it."

– **Nitin Gupta**, a partner at Caspian Private Equity.

"Not every GP's a rock star. We try to find the guy who's the true rock star rather than the roadie."

– **David Fann**, president and CEO of TorreyCove Capital Partners.

"The biggest pain points of GPs is most LPs are not quick at decision-making."

– **Praneet Singh**, a managing director at Siguler Guff.

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## From the panel **"Generational Smackdown: Millennials vs. Baby Boomers"**

"The healthcare system is perfectly designed for millennials. That is, if you do exactly the opposite of everything going on in healthcare."

– **Dave Chase**, a managing partner at the venture fund hf Quad Aim Fund.

"There's an opportunity in helping transition from an employer model to kind of the unknown."

– **Kayla Sanders**, the founder and CEO of cloud-based audit and compliance platform Remy.

"They are the forgotten demographic in healthcare."

– **Jay Parkinson**, M.D., the co-founder and chief medical officer at Sherpaa, on the 30-to-40-year-old age group who uses his company's services.

KEY FINDINGS

# Investing in Healthcare's Tech Boom

*Technology is playing a leading role in how healthcare is provided*

- **BEHAVIORAL HEALTHCARE IS RIPE FOR TECH DISRUPTION**
  With the mandate that insurance providers cover mental healthcare at parity with other health issues, this subsector is already in PE's sights. Telehealth is also a game changer in the space.

- **TELEHEALTH IS UNDERUTILIZED**
  Healthcare plans are hoping people will use telemedicine options, but consumers are resisting. An incentive from a health plan, like a price break, is often useful in gaining adopters.

- **EMR USE HAS SEVERAL STICKING POINTS**
  The use of electronic medical records in healthcare is slowly evolving, but there are roadblocks like data security and cross-border record sharing. The technology is there, but there is also resistance from some healthcare systems.

**Andrew Lindner**
Managing Director,
Frontier Capital

**Ezra Mehlman**
Principal,
Health Enterprise Partners, LP

**Brad Burkett**
Founder & Managing Partner,
Match Point Partners

# How Private Equity & Pharma Work Together

*Experts discuss where PE and VC can add value to the pharmaceutical industry, and what areas they should avoid*

- **ORPHAN DRUGS ARE AN OPPORTUNITY**
  Private equity and venture capital players find opportunities in so-called "orphan drugs"—those intended for rare diseases or disorders—if the risk level is low and the value level is high.

- **DUE DILIGENCE FOR PHARMA DEALS IS BRUTAL**
  Panelists said that due diligence into a pharmaceutical (or related) company takes much longer than deals in other sectors because of the regulatory and health risks involved.

- **NETWORKING WITH INNOVATORS IS CRUCIAL**
  Keeping in constant contact with those in the field developing new drugs and other treatments can pay off when you're the first to hear about—and have the opportunity to invest in—a new opportunity.

**Geoff Lieberthal**
Principal,
Lee Equity Partners

**Matthew Reber**
Managing Director,
Healthcare Royalty Partners

**Ellen Lubman**
VP of External Science
and Innovation,
Allergan, Inc.

# Deal Story:
## Why TPG 'Clicked' With EnvisionRx

**The founder of EnvisionRx and a partner at TPG—which invested in the company and ultimately exited via a $2B sale to Rite Aid—discuss how they teamed up to disrupt the pharmacy benefits management space**

**Jeff Rhodes**
Partner,
TPG Capital

**Barry Katz**
Founder & Vice Chairman of the Board,
EnvisionRx

**David Snow, Privcap: Jeff, how did you get the opportunity to invest in EnvisionRx? What did you like about the team and the platform?**

**Jeff Rhodes, TPG Capital:** We were very focused on PBM (pharmacy benefits management) for a number of years and met a lot of the market participants. While we saw there was an opportunity for change ... it didn't feel to us that any of the companies we were meeting with had the go-to-market approach or the mindset among the leadership team to try and take advantage of that opportunity. But then we heard about this business, EnvisionRx, through a mutual friend and managed to finagle a meeting, and it just sort of clicked.

The way that they were thinking about building their business made a ton of sense to us. One of the things that we like about the pharmacy supply chain and PBM in particular—one of the reasons we've spent so much time in it—is that

CONTINUES ON NEXT PAGE

it's probably one of the most complex areas of healthcare services. Traditionally, it's been one of the most opaque. The opportunity for an entrepreneurial team that expresses a different level of creativity and, frankly, hard work to do things quickly, is extraordinary. That was what we picked up on the first time we met Barry and his team.

**Barry, at the time that you were looking for partners, you probably had many different suitors from many different private equity firms. What did you like about the TPG team and their approach?**

**Barry Katz, EnvisionRx:** We had spoken to other private equity [firms] and they were very interested in numbers, what our plans were, and how we saw growth. TPG was interested in all of those things too, but what TPG was more interested in was our culture. I remember Jeff holding up our mission statement, saying, "This is what makes this company. This is what's important to us." That was a revelation to us, because we built a company that was our family. TPG was there to help us do creative things. All of those things just felt natural with them, and I think that's why we clicked. We've been friends ever since.

**How did you structure the deal so it worked for everyone?**

**Rhodes:** After the TPG investment, the founders maintained a significant minority position in the business. That's neither a passive minority nor a heads-up partner, so it's sort of unnatural. We talked a lot about that at the time, and we decided there was a common bond of trust. We knew that we were going to be able to figure out difficult decisions along the way, including an understanding from day one that we would all go and hire a CEO together, that we would have to figure out when we would seek final liquidity for the investment together—all those things that have inherent tension, we knew we would go into them with this in-between ownership structure.

**Barry, for those of us who are less familiar with the PBM market, what did it look like in the old days of "business-as-usual," and what was your idea to disrupt it?**

"We had spoken to other private equity [firms] and they were very interested in numbers, what our plans were, and how we saw growth. TPG was interested in all of those things too, but what TPG was more interested in was our culture."

**- Barry Katz, EnvisionRx**

**Katz:** We were in the pharmacy benefits management business, working for health plans, and we saw there was a lot of opacity. The way it was, the pharmacy contracts had "spread," meaning they were negotiated at one rate but they were charging another rate to the client. There were pharmacy rebates, which were a big source of revenue, and the PBMs were either keeping all of that money or they were keeping part of it. But they were sharing that information in such an opaque way that nobody knew exactly what the PBMs were keeping.

When we went into the business, we knew we needed to do something different, because the three large players at the time—now there's only two—were about 80 percent of the business. So we were looking at taking business away from them or the remaining 20 percent of the market. We needed to come out with a more disruptive model ... doing everything that they didn't do.

**Jeff, how did you think about the right structure and timing for the exit?**

**Rhodes:** When we got to the point when we were ready to exit, Barry and his co-founders had the mindset that the business was almost like a child, and they were thinking about the right long-term home for it. I think what was particularly attractive to them, because they had this mindset, was that they were going to become the pharmacy benefits platform for all of Rite Aid, in the same way that Caremark is for CVS. Now, the best-laid plans don't always turn out the way you expect ... because then Rite Aid was acquired by Walgreens six months later. But the way we thought about selling the business was motivated by the team's mindset, and we all felt good about the result. ■

# How Healthcare Reimbursement Is Changing PE Deals

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

*Private equity is increasingly looking to specialized areas of healthcare such as dermatology for investments because of their resistance to reimbursement pressures*

**Privcap: What specialized areas of healthcare is PE interested in?**

**Les Levinson, Robinson + Cole:** Behavioral health is a still an area that continues to attract a lot of private equity interest. Homecare, hospice, and dental are also attracting a lot of interest. Also, some sectors of the physician-practice area continue to attract a lot of private equity interest. Two examples there would be anesthesia and dermatology.

**What kinds of transactions are you seeing within those sectors?**

**Levinson:** We're seeing outright purchases of companies. We're seeing some minority investment alone—traditional private equity coming in and making an acquisition in areas they think are attractive. One other sector of note is revenue-cycle management. Data management and warehousing are other areas that continue to be interesting to private equity.

**In the past year, have you seen any changes in the types of transactions?**

**Levinson:** I would go back and look a bit deeper at some areas where private equity, perhaps, we thought, would be more interested in and have shied away from that. One big example of that is hospitals. Caritas Christi [Health Care] is a good example that was converted from a not-for-profit to a for-profit system in Boston several years ago. Cerberus Capital did that conversion, and we thought that might be a harbinger of other large conversions. There were a couple—I think two or three—that were done, but there really hasn't been a bellwether that we thought.

Hospitals continue to be under pressure from a reimbursement perspective. There's a lot of regulation there. There's a bit less freedom to do some of the things that perhaps private equity firms would want to do.

**What areas of healthcare does PE see as challenging at the moment?**

**Levinson:** Historical areas that have been under reimbursement pressure are going to be less favored by private equity. To some extent, facility-based situations that have a lot of brick and mortar—a lot of sunk costs into them that may not necessarily be easily recouped—are going to be a bit more challenging as well. I think things that create opportunities for synergies, for roll-ups, for management to create some of the value that private equity is known for are going to be more interesting.

**What areas do you see opportunities in for these synergies and roll-ups?**

**Levinson:** Behavioral health has been a long-standing favorite of private equity. If you look at some of the charts, you can see that deal flow continues to be active there. What it means, in large measure, to private equity is [that] addiction, treatment centers—the kinds of things that are not necessarily covered fully or covered at all by insurance—you're getting a lot of private pay.

For example, there are many procedures that are done in dermatology offices that are cosmetic, that are not necessarily going to be reimbursed by insurance. So you know that the dollars that are attributable to that procedure are going to be fully paid by the patient, and private equity is going to be able to enjoy those benefits more than they would be where there's an insurance cap on a particular procedure. ■

# The Day in Photos

## Images from Privcap's second-annual healthcare conference


▲ *Privcap's David Snow leads a Q&A session onstage.*

▼ *Panelists at the "Private Equity & Pharmaceuticals" breakout session.*



Privcap/
10K
Unique visitors per month
8K
Subscribers come to our websites to engage with
1.5K
Videos
Connect with a Private Equity Audience.
Build Your Relationships.
Grow Your Business.

KEY FINDINGS

# Investing in Diagnostics & Devices

*Whether this is a difficult time to invest in this subsector, or whether it could be an opportunity, depends on your point of view*

**Joseph Acevedo**
Principal,
Pharos Capital Group

**Greg Belinfanti**
Senior Managing Director,
One Equity Partners

- **COMPETITION HAS INCREASED**
  The number of healthcare-focused private equity funds has increased significantly in the last decade, and that has driven up asking prices from sellers of potential portfolio companies. As a result, investors are forced to become more creative and patient in their acquisition calculus.

- **SERVICES IS WHERE THE SMART MONEY GOES**
  There is significant growth in the services area of this subsector, such as companies targeting laboratories and med-tech. Combining companies and leveraging synergies can offer serious upside by taking advantage of the growth play without suffering high multiples. This is particularly true for small-to-mid-cap opportunities.

- **PRESIDENT TRUMP WILL HAVE LITTLE IMPACT**
  While Trump's policies toward healthcare and technology are somewhat opaque, little is expected to change for investors in diagnostics and devices because the sector is driven by patients, not politics.

# What's Driving Healthcare Private Equity Deal Flow?

*GPs are finding creative ways to offset the frothy valuations in today's market*

**John McKernan**
Vice President,
The Riverside Company

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

**Adam Dolder**
Managing Director,
Great Point Partners

- **VALUATIONS ARE WORRYINGLY HIGH**
  The multiples being sought for all kinds of healthcare companies are giving private equity investors pause but not halting deal activity. The high valuations are also spurring creative deal structuring and GP differentiation.

- **HEALTHCARE OUTSIDE OF HOSPITALS IS HOT**
  Especially strong deal activity is being seen in healthcare providers other than hospitals—in urgent-care centers and alternative site opportunities. These businesses are seen as more predictable, better able to take costs out of the system, and less exposed to reimbursement pressure.

- **NO ENTREPRENEUR, NO DEAL**
  PE firms almost never seek to buy a healthcare business from a group of managers that don't intend to be involved in the ongoing business in some way, the panelists said. Investors are looking for entrepreneurial management teams to help take the business to the next level.

# How the ACA Has Impacted PE Investing

Six years in, Obamacare has created niche markets in healthcare, Bain Capital Private Equity's Chris Gordon says in a keynote interview

**A lot has changed in healthcare in the six years since the Affordable Care Act came to pass. Since then, a handful of trends have emerged that continue to influence private equity investment strategies. Chris Gordon, managing director of healthcare at Bain Capital Private Equity, points to three key developments as being particularly impactful: healthcare coverage, payment models, and the staying power of hospitals.**

## Coverage Expansion

The widening of healthcare coverage created a bonanza of investment returns for firms that put capital to work in hospitals, physician services, or emergency-care-related businesses between 2006 and 2011, but Gordon says those firms could have been more lucky than prescient.

"Being totally honest, I doubt if many of the people—myself included—who made those investments were underwriting the idea that this coverage expansion was going to happen," he explains. "So that might have been a bit of a windfall and a bit of a bonus to a lot of transactions."

Firms that got in early reaped the benefits, but investing in healthcare subsectors impacted by coverage expansion has proven to have a small window of opportunity.

"Once [healthcare] reform went into place, it was pretty hard, because the market pretty quickly recognized that the benefits of that incremental coverage, and the impact it was going to have on...businesses and valuations, pretty quickly reflected that," notes Gordon.

## Payment Models

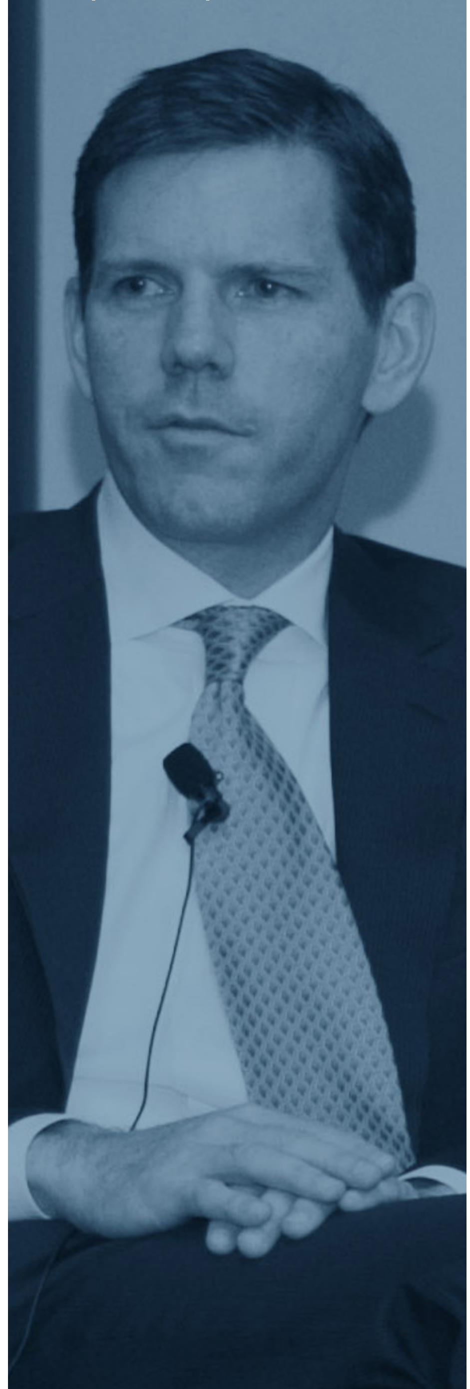
Gordon is particularly excited about the different advanced modes of reimbursement payments emerging in the healthcare sector and the opportunities for investment around them. Whereas some experts may be less inclined to believe these new models have staying power, Gordon, who acknowledges this part of the sector is still very much in the early stages, is a believer.

"An interesting thing for us about an investment for some of the other developing technologies around the healthcare payment space is that they really are starting to integrate with the provider data, with the clinical data," he says. "The physician benefits because their claim gets paid faster. The payer benefits because they don't have to have as much back-office [staff] trying to make sure that the claim is accurate. ... It just adds a lot of efficiency to the system."

## Hospitals

One of the most exciting points about hospitals for Gordon is that they sit at the "epicenter" of much that happens in healthcare. On the one hand, care continues to migrate to clinics and home settings, but on the other hand, Gordon is confident hospitals will continue to play vital roles in the healthcare ecosystem. Gordon explains that hospitals are part of the integrated platform of treatment and play an important role in the emerging payment models.

"There is a real tension there," he says. "Those are exactly the kinds of really interesting dynamics that make it an interesting investment space for private equity investors." ■



**Chris Gordon**
Managing Director,
Bain Capital Private Equity

# How One Company Is Using Transparency to **Streamline the PBM Industry**

The founder of RxAdvance explains how it is trying to help pharmacy benefit managers tap the market's full monetary potential

**Ravi Ika**
Founder & CEO,
RxAdvance

Pharmacy benefit management (PBM) and associated medical costs is a $850B market opportunity. Yet according to Ravi Ika, founder and CEO of the PBM company RxAdvance, technology limitations mean that companies are leaving more than half that amount on the table.

"It's inadequately addressed," Ika says.

RxAdvance is a national full-service PBM. Their Collaborative PBM Cloud platform promises to deliver integrated services that reduce overall pharmacy costs, optimize specialty spend by converting from "buy and bill"—in which physicians typically buy from their preferred vendors and pharmacies and bill the plan sponsor for the cost of the drug, as well as things like administrative fees—to "authorize and manage"—a 10-step process optimizing specialty spend—and reduce avoidable drug-impacted medical costs while improving a patient's quality of life through regulatory compliance and transparency.

"Twenty-five to 30 percent of medical costs are avoidable; half of those avoidable medical costs are physician or hospital abuse or overuse," Ika says. "The other half stems from 'avoidable drug-impacted medical costs'—costs that would not have arisen had the drug benefit been administered correctly and comprehensively." Having a PBM provider that understands the costs on the medical and pharmaceutical side can then lead to comprehensive solutions to address overall pharmacy cost reduction, and a significant reduction in avoidable drug-impacted medical costs, he explains.

RxAdvance is addressing the PBM market with three solutions: *nirvanaRxCloud*, which reduces the overall pharmacy costs through gains in efficiency; *nirvanaAccountableCare*, which aims to reduce avoidable drug-impacted medical costs; and *nirvanaSpecialty*, which aims to substantially reduce specialty medical costs while improving outcomes.

"These solutions are designed to improve transparency and relative value so everyone has the playing field to take their respective market share financially, based on relative value and equal compensation," says Ika.

He says that RxAdvance is leading the industry through system-driven compliance.

"We have the know-how, the platform, and the business model to transform [the industry]," he says. "In turn, if we can realize even half of the [untapped] savings that we have identified, that's more than enough to cover the uninsured and underinsured, while also decreasing premiums for all Americans." ■

KEY FINDINGS

# Aligning Interests Between PE Investors & Healthcare Executives

**Chris Cathcart**
Partner,
Halifax Group

**Andy Cavanna**
Healthcare Co-head,
Vestar Capital

*Two investors discuss how to best develop a productive partnership between private equity and portfolio company management*

- **PE INVESTORS LOOK FOR 'SIGNALS'**
  When evaluating a deal, PE backers want to see a committed management team. That's best expressed with money—in this case, by rolling over equity or putting their own cash into the deal.

- **SELLERS—DO YOUR DUE DILIGENCE**
  PE firms do extensive due diligence before buying a company. Management teams should go to the same effort when selling one. Call as many references as you can—you want to know that the PE firm will be there to back you when times get tough.

# Services & Outpatient Trends

*An expert view on the ever-changing dynamics of healthcare delivery in the U.S., and how to manage uncertainty*

- **CHANGE IS COMING**
  Obamacare's struggles and a Republican administration mean one thing is certain—healthcare services will continue to be subject to dynamic regulatory and economic circumstances. There simply is no status quo.

- **IS CONSUMER CHOICE THE FUTURE?**
  Our panelists disagreed. Howe felt that consumers will increasingly choose when and how they want healthcare services and what they're willing to pay for them, and that's a good thing. Blumenthal felt that too much choice is a bad thing—presenting fewer choices, but good ones, is the best path forward.

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

**Tim Howe**
Managing Partner,
Healthinvest Equity Partners

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