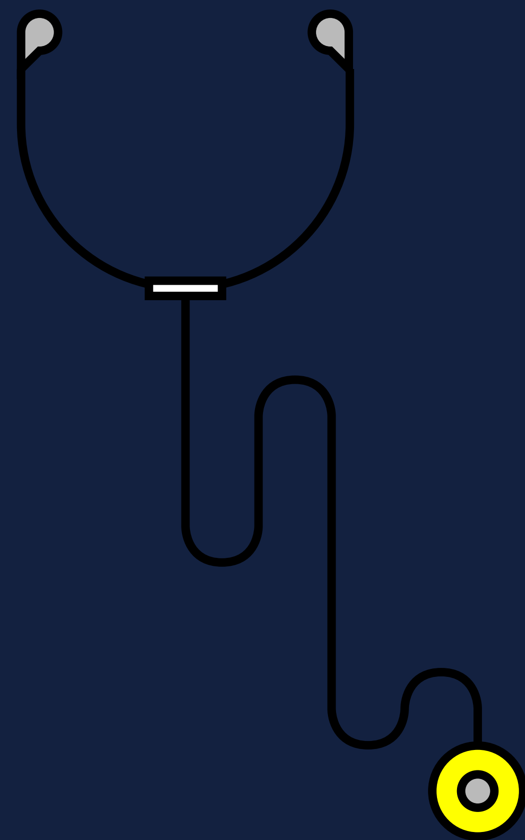
Q1 2018

Privcap/Report

Private Equity's Healthcare Revolution

How investor's can capitalize on the seismic changes in U.S. healthcare



Including:

The Consumerization of Care
Roll-Ups Are Back
Investing in Value-Based Care

Building a better working world

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David Snow
Co-founder & CEO,
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Consumerized Care

Private equity works best where the business being targeted needs not only capital but ideas. Is there an industry more in need of ideas than healthcare? There should be no surprise that this industry is increasingly capturing the attention, and investment dollars, of private equity firms eager to unleash new technologies and business plans on a market in need of a shake-up.

This report presents the latest thought leadership on the private equity opportunity in healthcare, and should be of interest to anyone doing business in the U.S. healthcare market, as well as to investors with an allocation to private equity who are no doubt keenly aware that a growing percentage of their overall private equity portfolio is dedicated to healthcare deals.

Among the trends commented on by the experts featured in this report is one that will have profound consequences for many rather hidebound healthcare businesses—patients increasingly demand experiences similar to what they expect from consumer and retail businesses. They are looking for clear and compelling communications as well as convenience. They are looking for trusted brands that deliver consistent experiences. They are puzzled that a rather expensive service requires them to fill out a paper form and can't send them a simple confirmation email. They don't understand what they are being asked to pay for.

The consumer and retail market has for years been fine-tuning its business practices, embracing social media and artificial intelligence in winning new customer spend. Many of these businesses have been guided by private equity and venture capital backers. These same investors are now unleashing similar digital strategies on healthcare businesses, with startling results. The strategies are not just about winning new revenue but about driving down costs. Example: making a patient who is buying eyeglasses also take a glaucoma test, an early indicator of diabetes.

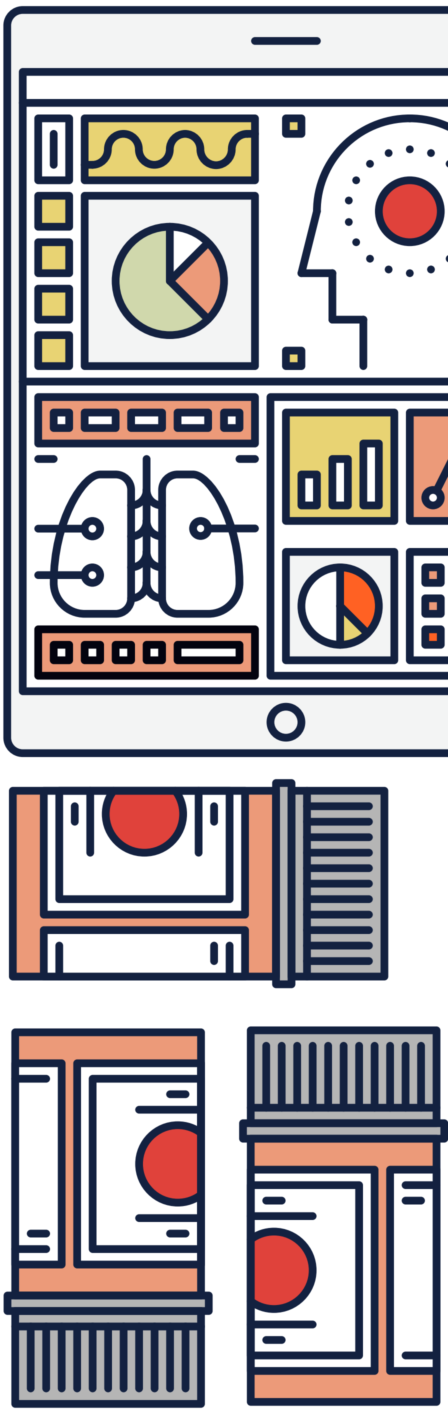
I hope you find many actionable ideas for your own business in this report.

Best,

David Snow
@SnowsNotes

The Consumerization of Healthcare

Private equity opportunities in a rapidly changing market



Key Takeaways

1. **Our healthcare system is taking a page from retail**
2. **Achieving operational efficiencies is hard, but PE has a role to play**
3. **The evolution of healthcare is opening new opportunities**
4. **Marketing to patients is more about modifying behavior than selling services**
5. **Expensive controllable diseases like diabetes are a huge opportunity for tech intervention**

1

Our healthcare system is taking a page from retail

Jacques Mulder
U.S. Health Leader,
Ernst & Young LLP

Brad Coppens
Managing Director,
One Equity Partners

Adam Blumenthal
Founder, Managing Partner,
Blue Wolf Capital Partners

The U.S. healthcare system is undergoing consumerization—a fundamental move toward a value-based market in which providers are more responsive to their patients. In this evolving market, healthcare "products" are delivered directly to patients, and patients are evolving from care recipients to participants who play an active role in managing their own health.

"There's a major shift to put the patient in the center of care," said Jacques Mulder, U.S. health leader at Ernst & Young LLP. "The patient is becoming much more of a consumer. Healthcare no longer means getting in your car and driving to a hospital where a bunch of people are gathered and hopefully you get the help you want." Instead, healthcare now means using tools like mobile devices to keep patients constantly connected to their physicians or caregivers.

One driver of this trend is cost. Patients are shouldering more of it, and that's compelling them to get more involved. "Americans who have employer-based coverage are now in these high-deductible plans," noted Brad Coppens, managing director at One Equity Partners. "People have more at stake in value-based purchasing simply because of plan design."

Meanwhile, on the supply side, providers are more responsive to consumers. For example, Blue Wolf Capital is involved in a joint venture with a New York-based health center to expand community-based healthcare.

"We've made it a point to get very close to the communities we're in," said Adam Blumenthal, founder and managing partner of Blue Wolf Capital Partners. "We show up at school events, Little League games, community festivals. Our doctors do educational sessions at local church groups. We have a distinctive logo, a distinctive T-shirt. We hire to match the ethnic diversity of the communities in which we do business."

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The centers even do immediate follow-up—a call or text to patients as soon as they leave the office asking how the experience was and, if it was not good, scheduling another follow-up to find out why. "We want to make it right," Blumenthal said. "That kind of engagement with each patient, that's what builds trust and builds repeat visits."

The Big-Data Advantage

Adam Blumenthal
Blue Wolf Capital Partners

Smartphones have the ability to put an infinite amount of health data in the hands of both physicians and patients. This is an advantage that was never possible before. "Every time we touch a patient, we know something about them," said Blumenthal. "But historically, much of that information has never been captured."

So now that we have the means to easily collect all sorts of health data, how do we start to manage it all? The trick, Blumenthal said, is narrowing the focus. "It's a matter of figuring out which five simple questions I'm going to ask every day and keeping track of that information so I'm able to act on it," he said.

Going forward, having huge amounts of data, including proprietary data, is going to provide competitive advantage for some healthcare providers. But we're still a long way from that point. "The truth is that we're so uncoordinated when it comes to organizing and managing the data we already have," said Blumenthal. "So just doing a good job with the information we currently have creates a competitive advantage today."

2

Achieving operational efficiencies is hard, but PE has a role to play

It's one thing for a PE firm to buy a widget factory and bring operational efficiencies. It's a different thing altogether to do this in healthcare. People's lives are at stake.

"If you say, 'How do we provide care that's rational and relative to the needs of the individual?' that's a medical question, not a private equity question," Blumenthal said. "But what the private equity firm can do is say, 'How do we build the infrastructure to make care accessible and allow it to access funding and live within a business structure that makes it sustainable?'"

For example, Blue Wolf has a home healthcare business in Massachusetts that combines three different business lines from three different companies: activities of daily living, skilled nursing, and hospice.

"We've merged them into one seamless set of services able to provide support to individuals," Blumenthal said. "There's enormous value in doing that. And that's our insight as a private equity investor: The fact that these things grew up separately doesn't mean that they aren't better together."

3

The evolution of healthcare is opening new opportunities

Consumerization will drive growth in new areas of healthcare. Surveying the market broadly, Coppens thinks there is room for improvement in any area where consumers or physicians can be incentivized to act on their own behalf to lower cost and improve outcomes.

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The Need for Clinical Quality

Jacques Mulder
Ernst & Young LLP

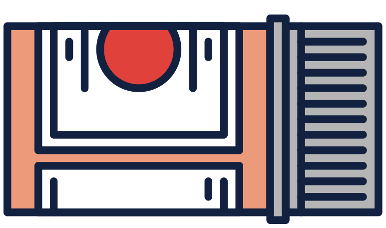
Most healthcare institutions believe the level of care they provide is excellent, but they have no way of proving it. Why? Because they don't do a good job of measuring and tracking the quality of the healthcare services they provide.

"I believe clinical-quality measures are as important as financial statements," Mulder said. "But healthcare providers don't always exercise the same level of rigor in how they enforce and manage that set of data."

Consumers are demanding objective data from healthcare providers that clearly demonstrates their ability to offer quality care. They want to find the best care, which means there needs to be an objective methodology to compare hospital to hospital, or specialty to specialty, and see which providers are delivering better outcomes.

"I'm on a very hard push to measure and compare clinical quality among institutions, so we can start answering the question of who does better care," said Mulder.

However, creating the right set of definitions is absolutely essential in measuring clinical quality. For instance, Mulder knows of one hospital that, at least on paper, had a bad track record when it came to patient outcomes. However, the way it defined and measured patient outcomes was significantly different compared with other hospitals. "So they looked like they were performing poorer, when in fact they were performing better," said Mulder. "That's why there's a whole taxonomy that has to be developed."



For instance, consumers with high-deductible plans will be increasingly motivated to seek out information that will help improve care at a lower cost. On the provider side, physicians who operate in a "capitated" environment (as opposed to the traditional fee-for-service payment model) will be compelled to seek out new tools that help them manage patient populations more efficiently.

"Those types of fundamental drivers are going to be really powerful in the healthcare space," Coppens said.

More specifically, Blumenthal thinks the combined trends of an aging population and cost control at the care level will drive growth in the post-acute-care sector. "You've got an aging, increasingly vulnerable population, and you've got a traditional venue of care—the hospital—kicking people out earlier, to put it bluntly," he said. "That creates a problem. We think those two major forces mean that post-acute care has to be a lot better coordinated and a lot more consolidated, so we're looking at that sector quite closely."

4

Marketing to patients is more about modifying behavior than selling services

Marketing in healthcare is different from marketing in other consumer businesses. It's more about messaging—conveying information to patients that will modify their behavior and bring a better outcome, for them and the provider.

Let's take a patient with a Medicare Advantage plan that also has a vision benefit. And let's say that patient contracts adult-onset diabetes. "Well, glaucoma is an early indicator of diabetes, so it's going to pay you, the provider, to remind your participants that they have a vision benefit," Blumenthal said. "Because whatever you spend on the glasses or the contact lenses, their health is going to improve because they chose to get the vision test."

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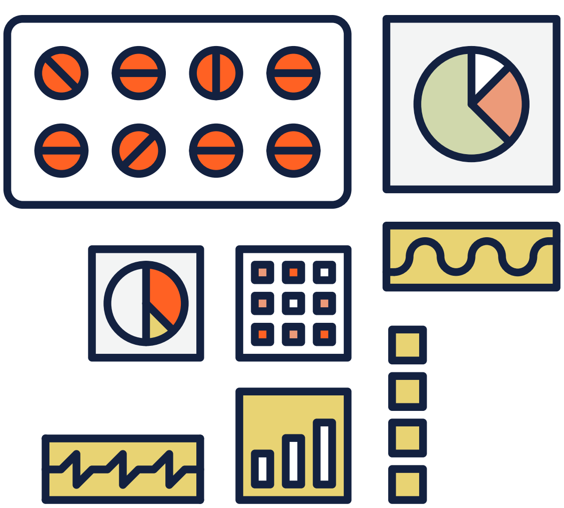
The Cost Benefits of Home Health

Brad Coppens
One Equity Partners

Given the choice, most patients would rather recover in the comfort of their own home. The good news is that home health is an affordable alternative to facility or hospital care. According to the National Association of Home Care, the average cost of care from a skilled nursing facility is $544 per day, while the average cost of home healthcare per visit is $132.

"We invested in a homecare business largely serving Medicaid patients who want to be in the home and do not suffer from an acute condition," said Coppens. "These people either have a disability or are simply old and need assistance to handle activities of day-to-day living. They consume care in the home much in the same way that they would consume care in an institution. They're just able to do so because the services have evolved."

As the home health revolution gains strength, it's having an enormous impact on cost reductions. "By simply identifying when a patient has a change of condition and bringing in the appropriate intermediary to assess what's going on, you can avoid a hospital admission," Coppens said. "All of a sudden, you've changed an enormous amount of the cost surrounding those services."



The message modifies a behavior, and that results in a better outcome. The patient chooses to engage with the healthcare system (the vision test), this delivers a desired outcome (the diabetes detection), costs are reduced (diabetes can be dealt with early), and the patient enjoys better quality of life.

That's healthcare marketing's holy grail: to influence patient behavior. "If you can get to that place, you're tapping into a piece of the risk equation that no pharmaceutical company and no clinician has ever been able to get into," Mulder said. "Finding ways to get patients to behave differently, more consciously about their health, that is going to be where the real magic happens."

5

Expensive controllable diseases like diabetes are a huge opportunity for tech intervention

Billions of people now suffer from behavior-related diseases like diabetes, congestive heart failure, COPD, and lung cancer. These illnesses are very expensive to treat when they become acute. But they also allow for early monitoring and intervention, which opens the opportunity for significant cost savings.

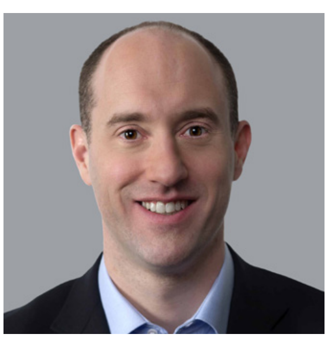
Typical diabetes patients visit the doctor's office once a year, and the rest of the time no one is checking them. That's why technologies that monitor existing diseases and warn patients and their caregivers when behaviors are off course present significant value.

"You can know what patients are doing," Mulder said. "Their activity level, how much they walked, when they took their medication. Put this all together and you wind up in a place where you can treat the diabetic for $400 a year, just because you have the connectivity. We're moving to a point where payment is fixed and the better your ability to deliver quality care underneath that payment ceiling, the higher your profit." ■

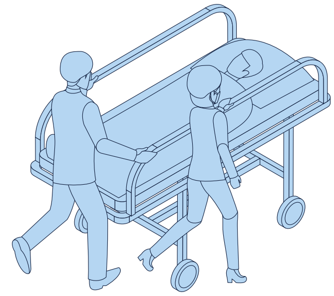
Ken Doyle
Senior Partner,
Halifax Group

Dan Schoenholz
Managing Director,
Co-head of Healthcare Practice,
EY-Parthenon

Gregg Slager
Global Health TAS Leader,
Ernst & Young LLP



Devin O'Reilly
Managing Director,
Bain Capital



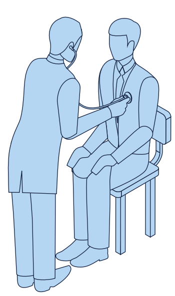
A PE Prescription for Rolling Up Physician Practices

Private equity deals in the healthcare sector are ramping up, driven in part by roll-up deals with physician practice groups that see scaling up as the right response to the industry's rapid evolution.

Private equity stepped into the space two decades ago with mixed results in terms of creating lasting value, but refinements to the transaction model and the industry-wide shift to vertical integration have spurred renewed and growing interest.

Physicians working in the sprawling U.S. healthcare industry, which accounted for $3.3 trillion in spending in 2016, have many options for organizing themselves and making a living. Increasingly, they're opting to join a practice group. Last year marked the first in which fewer than half of U.S. doctors owned their practice, according to the annual American Medical Association's Physician Practice Benchmark survey. More than 80 percent now belong to practice groups—some are physician-owned; others are backed by private equity firms, hospitals, and other healthcare companies. About one-third are in groups with at least 30 physicians, and almost 20 percent of all U.S. doctors work in groups of more than 100 practitioners.

For private equity, it's a fairly typical model for industry consolidation—leveraging economies of scale—except that it's being done in a complex sector where the most important assets are trained medical professionals. That requires a particular sensitivity and specific kind of due diligence, say healthcare private equity leaders.



"There's been a proliferation [of physician practice deals] in the last several years, because the model has been proven out," says Dan Shoenholz, managing director and co-head of the healthcare practice at EY-Parthenon. He says purchase multiples are rising, with small practices often fetching 6x EBITDA and larger targets attracting as much as 15x.

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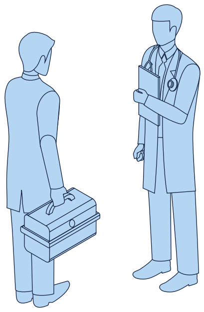

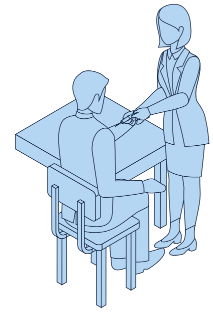

The current wave of transactions began in more "retail" oriented areas of the business such as physical therapy and even veterinary medicine, but has spread to more complex specialties including dermatology and ophthalmology.

In all, physician practice group transactions in 2016 contributed a greater year-over-year share of the $278 billion aggregate value of healthcare and life sciences deals tracked by the digital services provider Statista, and private equity funds continue to see a promising market. The total disclosed deal value of private equity healthcare investments hit $36.4 billion in 2016, the highest total since 2007, representing 14 percent of the global deal count tracked in the *Global Healthcare Private Equity and Corporate M&A Report* 2017, released by Bain & Co. and the Healthcare Private Equity Association.

Too Many Second Opinions

The current momentum comes in part from learning from past mistakes, says Gregg Slager, EY global health transaction advisory services leader. Private equity firms launched a spate of Wall Street–backed practice group deals in the late 1990s and early 2000s that touted the potential economies of scale, but many didn't pan out.

"What they didn't get right was the culture," Slager says. "Physician leadership was really important, and so was stakeholder buy-in. Without that, a lot of those deals flamed out."

He says that what's changed is that the governance structure of many physician practice groups involved in consolidation transactions is more concentrated, which now makes the decision-making side of these transactions more efficient. That in turn helps structure physician compensation in the new organization, which improves retention rates and reinforces a sustainable business model.

Ken Doyle, a senior partner at the Halifax Group, a private equity firm that works in the lower middle market and has numerous health and wellness companies in its portfolio, says assessing the ownership and decision-making structure of a physician practice group is often the most critical aspect in due diligence.

"A challenge that we saw early on with these types of transactions was that in many big practices, every doctor had an ownership interest, and they couldn't figure out the decision-making," he says. "In a lot of cases, that was a disaster. Too often, everyone spent a lot of time on transactions that ultimately didn't happen."

Advisors and investment bankers who bring them deals have learned to describe the ownership structure early in the discussion, and it has generally gotten easier as more practice groups adopt more concentrated ownership structures.

"Physicians have really changed their views about this in the last 10 years," he says. "Many say they are not interested in owning their own practice for lifestyle reasons—they don't want to deal with the administrative and compliance and contracting issues that are part of being a business owner."

Shoenholz says presentation is critical when negotiations reach a substantive stage. Physician earnings may take a short-term impact as a group is scaled up and combined in a larger organization, but as long as the participating doctors are assured they'll be able to provide the same quality of care, the right compensation model can be a decisive factor.

"They will often need to be convinced that they can repair that income, but it's very possible that they will do better in a more complete practice," he says.

Another key to effective due diligence is ensuring the accuracy of a practice group's pro forma EBITDA. Deal teams must factor in the earn-outs and other compensation incentives to establish a realistic baseline.

"We need to see that those salaries are really market rates," Doyle says. "Over time, physicians come and go, and we have seen situation where buyers have gotten burned because the pro forma compensation wasn't what it took to bring in new doctors who were not owners."

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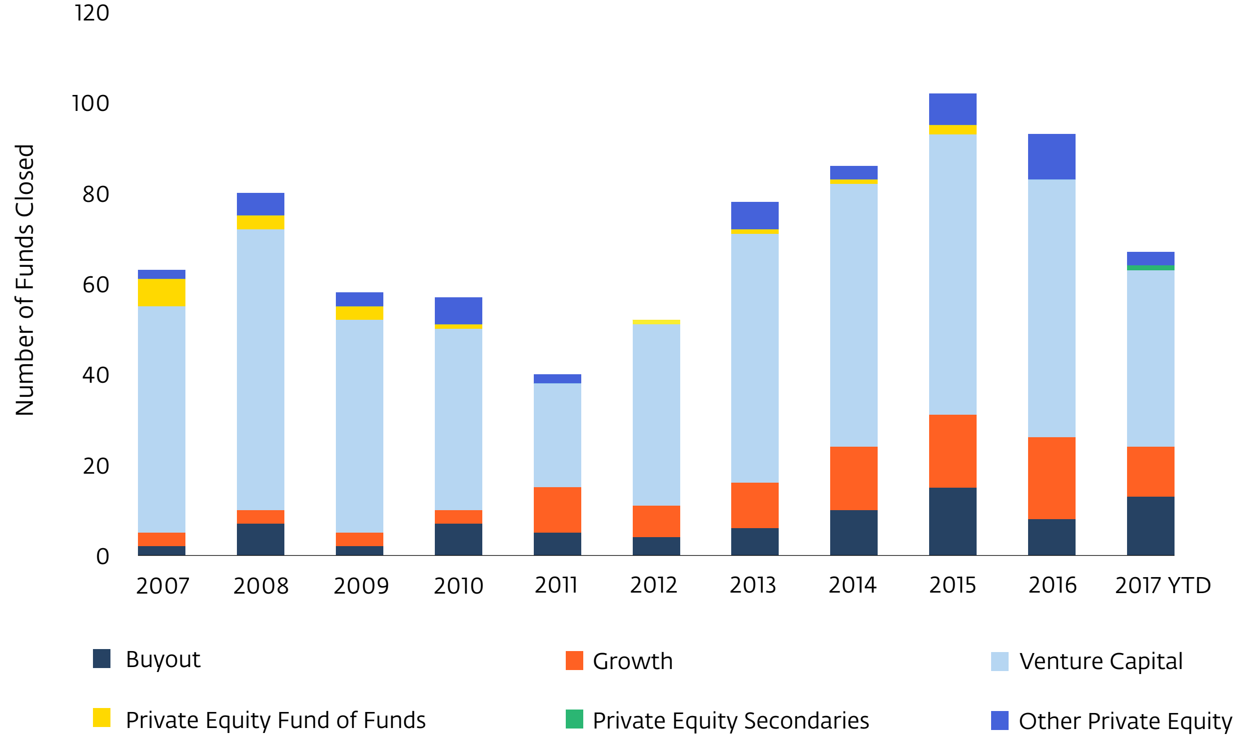
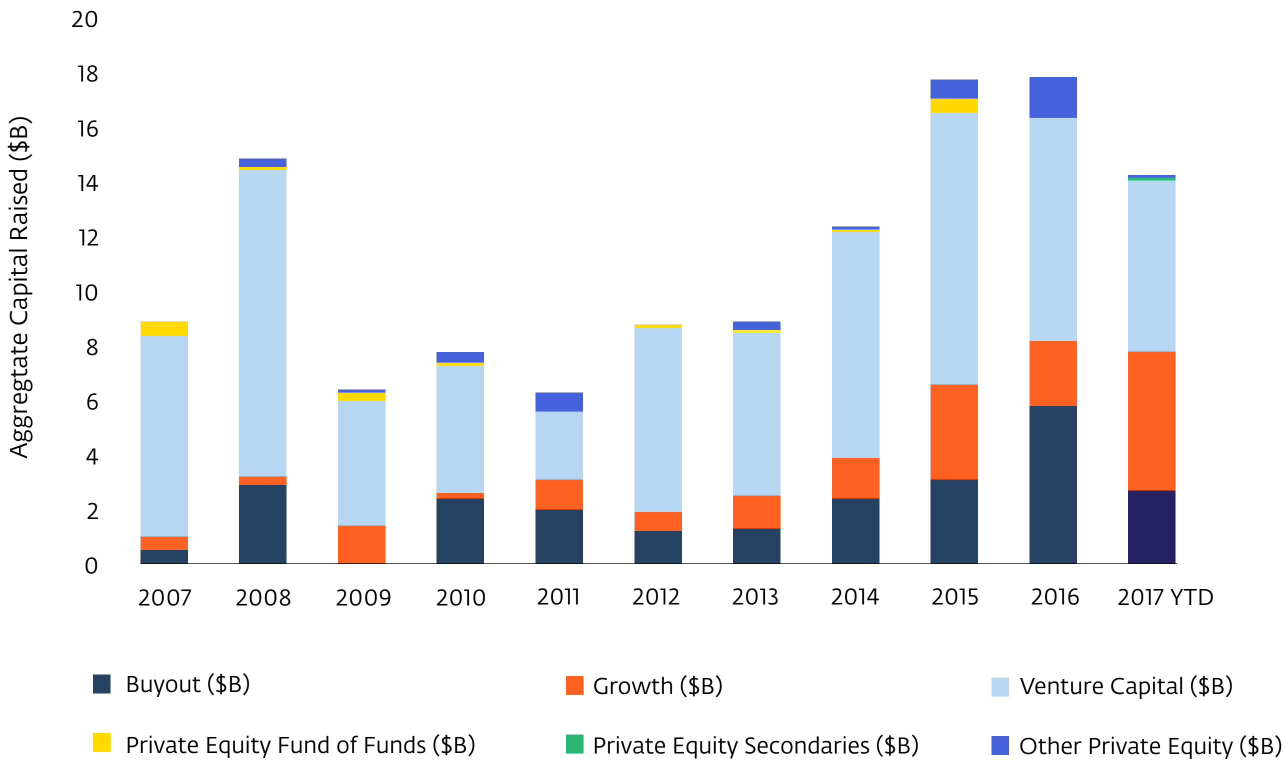
Number of Healthcare-Focused Private Equity Funds Closed



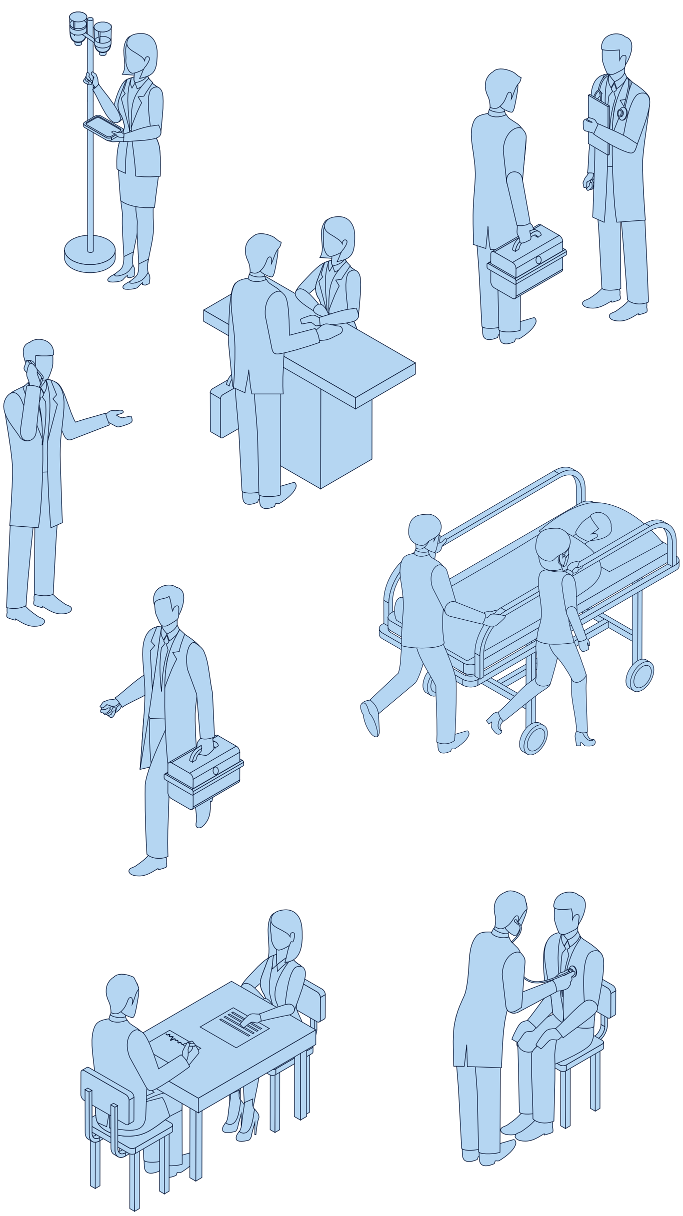
Healthcare-Focused Private Equity Capital Raised

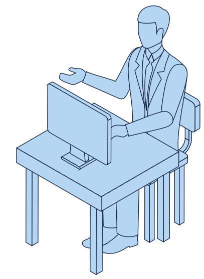


Source: preqin

Devin O'Reilly, managing director at Bain Capital Private Equity, adds that in the current physician marketplace, where many provider organizations are looking to employ doctors, a sustainable and attractive compensation model is a must have for any deal

"Physicians may often be content for a period of time following the initial deal, but if their overall compensation isn't tied to longer-term incentives that are well aligned with the parent company's objectives, their interests may diverge over time."





Making the Right Pitch

Shoenholz, at EY, says private equity firms that don't specialize in healthcare will need to assure their practice group targets that they understand the intricacies of the industry to build up their deal portfolios. That could include establishing a dedicated pool of capital for these transactions or retaining operating partners with solid track records in medical practice management.

"It is a competitive market, and the shops that can say, 'We've done this with dental practices, we've done this with physical therapy, and now we see this opportunity for your ophthalmology practice,' have the advantage," says Shoenholz. "If you don't have a 20-year, 10-year, five-year track record, you will have to be able to tell them who they're working for, so the choice of an operating partner is important."

A well-run platform, with a business model that can accommodate growth, is the key to a successful practice management roll-up, says Slager. At EY, the deal range is vast, from a $1.4 billion transaction that saw a large medical practice group change hands to exploratory conversations about combining a handful of dental practices.

The central theme is creating a model that, like the entire healthcare industry, can focus on measurable patient outcomes. If that takes outside investment to support administration, equipment, or real estate needs, such as expanding the number of locations of urgent care clinics or dentistry centers, the end result is often more convenience for patients, he says.

Doyle, at Halifax, says the consolidation of physician practice groups is part of a set of much larger, connected and interdependent moves through the entire healthcare industry.

"Everybody is in something of a chess game here as everyone moves in the direction of consolidation, and the question is, who is going to control what part of whole patient flow?" he says. "If you look at where government is going on their payer structure and where payers are going, you'll see more bundling. People naturally want to control the cost structure as much as they can." ■

Carole Faig
U.S. Health Deputy Leader,
Ernst & Young LLP

Roger Holstein
Managing Director,
Vestar Capital Partners

Adam Dolder
Managing Director,
Great Point Partners

Investing in Value-Based Care

Private equity healthcare professionals discuss the investment opportunity in a transforming market

Key Takeaways

1. U.S. healthcare has chronic disorders
2. Value-based care offers a solution—and a PE opportunity
3. There is room for improvement in transparency
4. Investment is flowing to new healthcare sectors
5. Behavior modification is the 'holy grail'

1. U.S. healthcare has chronic disorders

As we all know, U.S. healthcare is not in the best shape. It's costly, with healthcare spending now almost 18 percent of GDP; spending per person is more than $10,000 per year. And it's inefficient, as Americans' relatively high spending on healthcare services hasn't made us healthier than those in other countries.

"As a nation, we spend 2.4 times per capita more than other industrialized nations, and yet we rank 35th in things like life expectancy, obesity, and infant mortality," said Roger Holstein, managing director at Vestar Capital Partners. "What we have is overutilization of expensive procedures."

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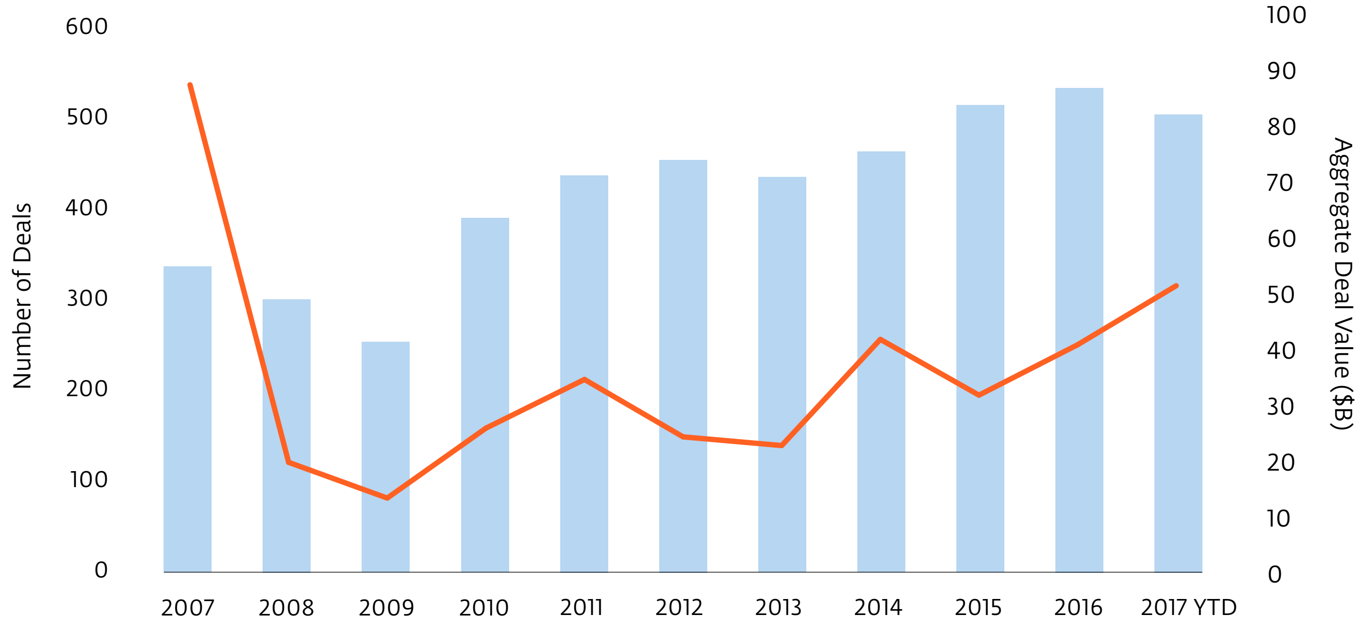
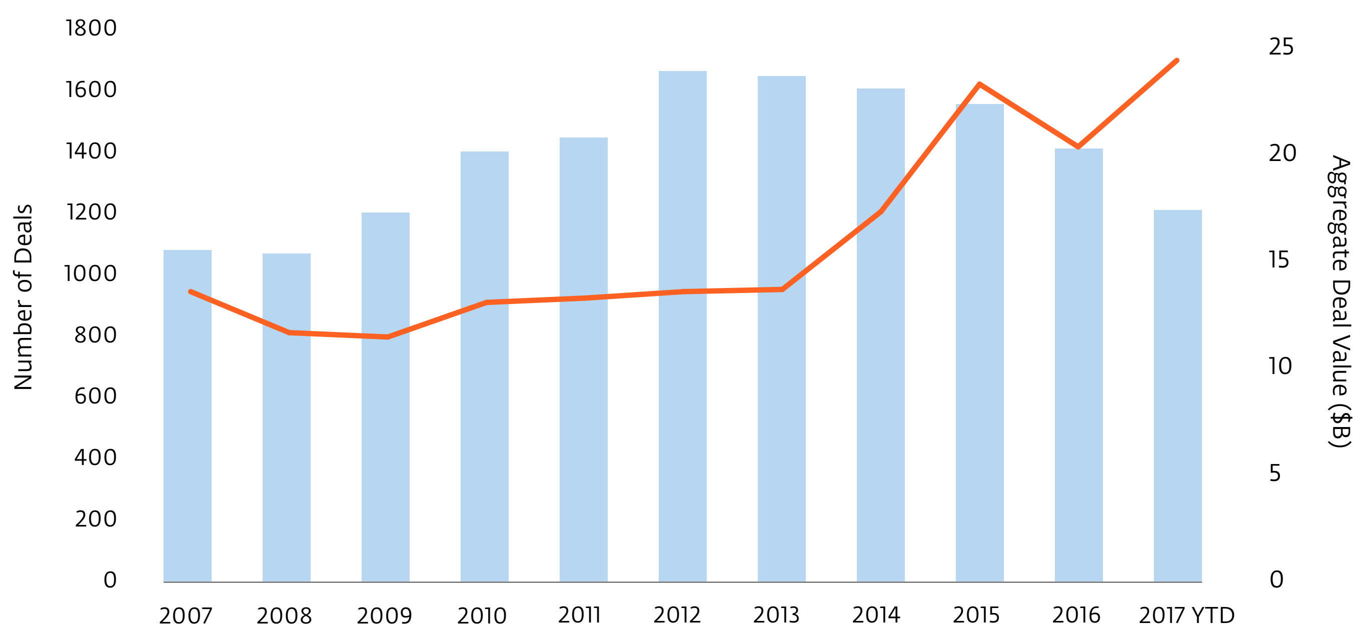
Private Equity-Backed Buyout Deals in Healthcare



Venture Capital-Backed Deals in Healthcare



Number of Deals
Aggregate Deal Value ($B)

Source: preqin

Americans get three times more MRIs than people in other industrialized nations, twice as many coronary artery bypass surgeries, and two and a half times more heart valve replacements and knee replacements. The primary reason: Our healthcare system incentivizes higher utilization rather than better outcomes. In our "fee-for-service" system, payment depends on the quantity of care, not the quality.

There's a fundamental mismatch: Doctors are paid more when they administer more, but patients typically don't pay more when they receive more. "The patient is not really a consumer, because he or she hasn't borne a significant amount of the cost of the healthcare system, so why wouldn't [they] maximize utilization of the system?" said Adam Dolder, managing director at Great Point Partners. "Why wouldn't I see the GP, then go to the specialist, go to the second specialist, [if it is] largely without massive economic consequence to me?"

AI for Smarter Healthcare

Roger Holstein
Vestar Capital Partners

Artificial intelligence is starting to tackle some of world's biggest challenges—including the diagnosis of disease. There is a need for AI because, while physicians learn to pattern-match very well, they sometimes miss problems. They may see 99 patients presenting with similar symptoms and correctly diagnose migraine, then miss a brain tumor in patient number 100. AI systems have a huge advantage in correctly diagnosing such outlier cases.

"AI can play a very important role in freeing up doctors to be much more efficient," said Holstein. He added that there are actually chatbots in the market today that are having conversations with patients and helping to administer a higher level of care.

"With AI, all of a sudden our mobile phones can come alive and have a conversation with us," he said. "It can drive us to ask and answer questions that will allow the receipt of new data that's needed by the health system to know how am I doing, has my weight changed, have I been eating correctly, did I take my medication, am I adhering to my treatment?"

AI can even help pre-identify critical patients and call them to the hospital immediately, thus improving outcomes and reducing the cost of healthcare. "This issue of constant communication is a big opportunity," said Holstein.

2. Value-based care offers a solution—and a PE opportunity

The headlines these days are all about Obamacare and the GOP's campaign to kill it. But healthcare is already changing fundamentally, from a volume-based to a value-based system, in which providers are incentivized to offer better care at lower cost. The Department of Health and Human Services is making plans to move 50 percent of traditional Medicare payments to value-based payment models by 2018.

"Healthcare is going through transformation, disruption, whatever term you want to use," said Carole Faig, U.S. Health Deputy Leader at Ernst & Young LLP. "And if you look at the trends that are driving that, they'll continue no matter what's going on in Washington. As millennials begin to age, they want to access healthcare in a different way. It's really consumers' desire to access the system in a different manner that will drive the opportunities for investment."

Dolder noted that his firm, Great Point Partners, focuses entirely on investments in companies that either reduce cost or boost efficiency. "The meta-theme of the firm is that if you don't either lower the cost of care or increase efficiency in the system, you're not going to get into the Great Point Partners portfolio. We view those as the two fundamental drivers."

Roll-ups have long been a mainstay in the PE playbook, and they'll continue to be so under a value-based healthcare system, particularly roll-ups of physician practices. Yes, roll-ups of practices were a thing 20 years ago—and many did not work out—but new tools and infrastructure may make them more successful this time around.

New technology platforms like revenue cycle management and electronic medical records are expensive to implement. "So to survive, you've got to leverage that expense across a number of physicians," said Holstein. "Secondly, with the

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Legislation vs. Innovation

Carole Faig
Ernst & Young LLP

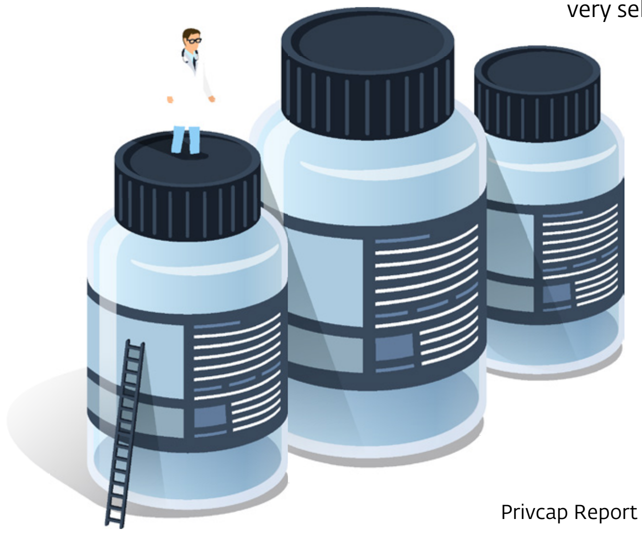
There has been a lot of commotion lately over the fate of Obamacare, but Faig thinks the legislative side of healthcare is largely white noise, at least from an investment perspective. "It's really the consumer's desire to access the system in a different manner that's causing disruption and driving the opportunities for new investments," she said.

Take, for instance, the development of wearables. Today diabetics can wear a watch that monitors their glucose levels without the need for inconvenient and painful blood tests. "Consumers are going to be able to manage their own care, and technology will continue to move it forward," she said. "When you suddenly have all this information available to you through technology, you're going to be smarter about your care."

Still, she admits, the current dysfunction in Washington is slowing the pace of innovation and evolution. "The regulatory discussion we're having today is focused so much on who's going to pay for the healthcare and not on the systemic issues of the consumption of healthcare," she said. "We've got to turn that dialogue around and start talking more about the consumption of healthcare versus how we're going to pay for it."

merit-based incentive payments system [MIPS], which is the new performance-measurement tool for individual physicians, getting access to data and interpreting that data is not something a small practice is going to be able to do on its own."

Another driver of consolidation is the fact that new tool sets that practices use to acquire, engage, and retain patients, and build business with them, are difficult to access for small providers. "There is real opportunity in the provider space," Holstein said, "but values right now are extremely high, so you have to be very, very selective."



3. There is room for improvement in transparency

The healthcare market will work better when consumers make better decisions. To do so, they need access to information about the price and quality of healthcare services. But until now it has been very difficult for consumers to get this information. Companies that can give it to them are poised to grow, and firms that invest in those companies are poised to benefit.

Holstein gave an example: Vestar's investment in the nation's leading provider of patient satisfaction surveys. "We recognized several years ago that the government was likely to include patient scoring in value-based purchasing, and this actually came to pass," he said. "We acquired the company when it had 50 percent market share of all hospitals in the country, and people thought we were crazy. But when we exited the investment, we were at 70 percent."

Consumers need better information tools. They need to know the mortality rate between hospitals; to know the likelihood of infection after a certain surgery; to know the effectiveness of a meniscus operation. And they need tools better than Internet search. "A lot of the innovation that will drive us from volume to value stands at this intersection where consumers can make informed decisions," Holstein said. "There's a huge opportunity in that space."

4. Investment is flowing to new healthcare sectors

As the volume-to-value transition disrupts healthcare, opportunity is opening in new sectors. One is the location where care is delivered. "We see a tremendous transformation from inpatient care to outpatient care," Faig said. "Less and less is being done within the four walls of the hospital."

↓ CONTINUES ON NEXT PAGE

A Cure for Healthcare?

Adam Dolder
Great Point Partners

Companies that can remove the veil of secrecy around healthcare and make information transparent will be among the big winners going forward, Dolder thinks.

In particular, he would love to invest in a company that can provide price transparency and help consumers see the true cost of healthcare. "I'm loath to give away my best investment ideas, but a company like this doesn't exist yet," said Dolder. "We've been looking for years. I just want to see it built."

In an ideal world, such a company would let consumers know exactly what they're going to pay for a particular medication—well before they go to the pharmacy. So if the consumer would rather buy the generic version of that drug and pay less, they'd have that option.

"There is no real-time adjudication within the healthcare services paradigm, and it's ludicrous that it doesn't exist," he said. "You should know more than just being able to price out an MRI. You should be able to know, on a prospective pricing basis, this is what it's going to cost me if I use physician A versus physician B or if I go to facility C versus facility D. And it's still opaque. We don't know if there's a $1,500 copay coming down the pike, but that's information we should have on the spot."

"If we're going to address cost concerns in the U.S. healthcare system, we have to move care out of the most expensive parts of it, which is acute care," Dolder said. "The cost per square foot to deliver care there is unsustainable."

Specific sectors Dolder singled out as ripe for investment include homecare and areas of medicine that can be further consumerized, such as dentistry and dermatology. "In provider-based businesses there is a big buzz around dermatology, and people still like dental," he said. "These are areas that have consumer overlays to them, and you see a lot of capital in pursuit."

5. Behavior modification is the 'holy grail'

With the majority of illnesses caused by unhealthy behaviors—90 percent of type 2 diabetes, 80 percent of coronary artery disease, 70 percent of stroke, nine out of 10 cancers—companies that are able to modify behaviors will be big winners.

This modification can be approached in straightforward ways, such as fiscal incentives, or subtle ways, such as social techniques. "I don't want to make it too simple, but I believe people do exactly what you incentivize them to do... Copays, coinsurance, deductibles can be set to encourage people to take a first look at a particular path," Dolder said.

Another option is to make certain options more attractive to consumers. "You can drive consumer behavior by the experience itself," Faig said. "By making the access easier, delivery of the service easier, addressing the issue from a customer/patient experience perspective. There's opportunity there to influence the consumer."

Of course, the masters of behavior manipulation these days are social media platforms, and there is broad opportunity there for healthcare applications. "Social media appropriated into the healthcare space is going to be a very important part of the equation," Holstein noted. Engines of social connection have a huge influence on how we behave, and there are many companies looking at this right now. If we can influence the health of the population that way, there is real opportunity there." ■

Jacques Mulder
U.S. Health Leader,
Ernst & Young LLP

Clinical Quality Is Key

with EY's Jacques Mulder

I believe clinical quality is as important as our financial statements. But we don't always exercise the same level of rigor in how we enforce and manage that set of data, or in how we report and how we use it as a management tool.

Clinical quality is becoming important for many reasons, starting with the preventable harm that occurs in institutions. That's something that we have to work very hard at minimizing and potentially eliminating. More importantly, though, consumers want to find the best care, which means there needs to be a methodology to be able to compare hospital to hospital, or specialty to specialty, to compare which ones have had better outcomes.

We should try to understand and value clinical quality and the influence it has on transaction price. We're pretty far down the path of being able to create an index and the right definition sets. We've seen instances where the analysis of those data have implied that a certain hospital has many more deaths than anyone else. But the definition of death and how they counted it was significantly different from the other hospitals. So they looked like they're performing poorly, when in fact they were performing better. There's a whole world of taxonomy that has to be developed.

Clinical quality is absolutely critical, and there's no one better in this place than EY right now. ■

3 Priorities for PE Investors in Value-Based Care

Carole Faig
U.S. Health Deputy Leader,
Ernst & Young LLP

Privcap: What priorities will firms need to balance as we move to a value-driven care model?

Carole Faig, Ernst & Young LLP: They have to think about elevating the patient experience. It's going to be important that the consumer feels like they're being served. There's a concept of transforming the culture. You have to think about the way that care is being delivered. It has to be more collaborative between physicians and the various settings of care.

What role does analytics play in a value-driven care model?

Faig: You have to be able to have data that is going to help you understand how to make predictive decisions around care to drive the best clinical outcomes. You have to be able to increase productivity. You have to be thinking about how to deliver care in the most effective manner while utilizing your resources in the most productive manner.

What about costs?

Faig: You have to think about how to balance managing your costs with managing the productivity of your organization That means embracing new ways to pay. There are going to be the various partnerships that come about between payers and providers and understanding how you're going to ultimately be reimbursed for delivering those value outcomes. ■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