Spotlight on Healthcare – A Special Industry Report (First of a Series)

THE LEAD | March 22, 2018

The private equity firm Platinum Equity announced last week they had offered to buy Johnson & Johnson's blood glucose monitoring product for about $2.1 billion. The LifeScan Inc unit was one of several J&J businesses focused on diabetes devices. The medical products giant had apparently experienced declining revenues and squeezed margins in that arena and had been considering their strategic options.

As middle market lenders, we are always on the alert for sectors in which our borrowers could come under siege from large strategic corporates. That's one of our featured risks. It's less common when a major competitor exits an area of historic dominance. But clearly the world of healthcare is changing.

Over the next several weeks we will explore the healthcare industry from the perspective of private equity and private credit. What are the major trends? Which sub-sectors are favored? Which ones are problematic? How do sponsors think about growth strategies in services vs. products? Where is technology the most disruptive?

We'll solicit the views of top firms – private equity and lenders – on how they're addressing these and other issues in a leveraged environment.

But first let's start with an overview. Healthcare, as we know, is a huge component of our GDP. According to CMS, healthcare spending was $3.3 trillion (2016). That's $10,348 per person. As a share of GDP health amounts to around 18 percent. Compare that to total defense spending, which is only 3.5% of GDP.

And that population is aging. One source reports the number of Americans age 65 and over will double by 2060. At 98 million that will be almost one in four of us. Good news for Golden Corral and those early-bird dinners. But bad news in terms of getting a handle on healthcare costs. Particularly when, in an astounding statistic, 50% of those costs are attributable to only 5% of the US population.

Hence the growing focus on low-cost treatment environments. That drives everything from hospital management to physician practice groups to outsourced diagnostics and treatment. It's also behind advances in surgery where minimally invasive procedures reduce patient recovery time and chances of infections. Or even better, avoiding surgery altogether with emphasis on preventative medicine and wellness.

Still looming in the background from a regulatory perspective is the Affordable Care Act. The failure of Congress last year to repeal or replace ACA may lower concerns of dramatic changes in national coverage, but political risk remains and healthcare investors will continue to be wary. Same goes for reimbursement risk which every lender in the space knows can significantly affect profit margins for healthcare providers.

Next week we'll turn to healthcare in the capital markets. As our *Chart of the Week* highlights, the middle market has been an active and growing space for the industry since the credit crisis. We expect no less for the year ahead.