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

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So far in our healthcare series, we've shown a sampling of private equity and advisory perspectives. This week we get views from lenders in the sector.

One specialist was instructive. "Healthcare remains local," she told us. "Florida, for example, is a very different market than the rest of the country. This makes it tough for national players to centralize. We start by analyzing systems to confirm our borrower is an operational leader with a strong clinical and administrative staff."

What do you diligence to ensure that? "Nurses typically file medical data sets so the provider gets paid by the government," she said. "If they're good you'll get paid what you're supposed to be paid, otherwise you may leave money on the table. So the quality of information and the knowledge level of the staff is critically important.

"Lenders, and even sponsors, don't always understand that in patient care facilities, the most junior staffer is as critical as the top doc. They are the daily managers. That applies across the spectrum of care settings – hospital, nursing home, detox, rehab."

Another top lender in the space agreed. "Operational effectiveness is the most important linchpin," he said. "Reimbursement risk is manageable with the right team. You need to look at the states you're operating in to see if Medicare/Medicaid payments are going to be timely. And you need to stay close to state regulations."

So healthcare is local? "Absolutely," he said. "With state budgets stretched, there's enormous pressure to delay payments. That can negatively impact financial results."

Are there differences between lending to a sponsor controlled business and one that's family owned. "Founders and families are generally in it for the long run," our first banker said. "So investments are stickier. They will double down if something isn't going well. But they have less wherewithal than deep-pocketed sponsors. You just have to understand that PE enters a business with their exit already planned."

Any sectors you like? Dislike? We've heard detox and rehab is tough. She thought for a minute. "Totally agree with that. You want a very small percent coming from lab work. There have been enormous abuses. We're also very cautious on home heath."

Why is that? "It's better than it was," she said. "The better operators have improved IT and communication between on-site nurses and the management team. As the service and tracking improves, the business becomes more financeable.

"By the way," she concluded, "loved ones need to closely monitor how your relative is being cared for. There's no substitute for family members asking tough questions."

Finally, we asked a third source – a long-time healthcare practitioner – how to protect yourself against reimbursement risk? “Providers don’t go bankrupt because of reimbursement rate changes,” he said. “Operators should be able to manage through tough environments by cutting costs. The real killer is too much leverage.”