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

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We close our special healthcare series with a discussion of risk.

“Increased risk is one of the primary concerns we consider,” said Rod Rivera, managing director in Capstone Headwaters’ healthcare practice. “The world of healthcare, as you’ve been detailing, is changing. All the subsectors that have great CEOs and built the best platforms are asking, how does the world of capitation change the equation? And in turn, are lenders looking in the rear-view mirror rather than the front windshield? Are smart equity people anticipating the change or are they bidding properties up because they can leverage it?”

His colleague, David Baker, agreed. “Those are the right questions. Where are things going? What are the risk elements? And how does private equity address it? Value-based care is definitely the theme of the day. Self-insured companies have been pushing value-based for years. Self-insured payors like Leapfrog Group, Health Transformation Alliance and the JP Morgan/Amazon/Berkshire venture can combine resources, using scale as leverage to lower costs and innovate in care delivery.”

How are costs and service linked? “Risk is reduced in a fee for service environment,” Mr. Rivera told us. “That’s shifted in a value-based system. If you deliver an outcome at a lower cost, you can keep a percentage of the savings. That’s the new normal. The risk is in the contract and execution. The risks to the investor are if the service provider is not operating in a value-based model, the current pricing may go away. The question for the investor is, is the company using the new playbook, or the old one?”

“I see two pieces of risk,” Mr. Baker said. “First, there’s the current landscape of disruption into a value-based model compared to whatever your company’s strategy is. Second, there’s execution risk. The contracts become much more important in the delivery in a value-based model.”

“Yes, and in loan land,” Rod Rivera said, “you need to think about what’s the correct leverage point for these risk elements. Have the credit markets fully absorbed the dynamic reimbursement models?”

“If there’s a valuation gap,” his colleague went on, “you can use structure to accommodate that. For example, using earn-outs as part of the purchase price. That way the buyer is risk-protected. Other times, the client may need to advance certain things – new line of business, new customer contracts – before presenting to private equity, there are things you need to do before they go to market. By reducing risk for the buyer, it can be an easier discussion versus setting up post-close milestones.”

What of the future? A friend in the space weighed in. “It’s still a question of how we as a nation deal with haves and have-nots,” she said. “Having insurance is not the same as having choice. If you can’t get to the doctor or special care unit, what good is it?”

“Don’t underestimate technology and innovation,” another told us. “Today 90% of children with acute lymphoblastic leukemia can be cured. With research, both private equity and private credit can play key roles in

the future of our nation’s healthcare.”