

# Privcap / Report

## Investing in Value-Based Care



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

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## The Experts

### 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'



**Carole Faig**

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

### 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."

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?"

### 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



**Roger Holstein**

Managing Director,  
Vestar Capital Partners



**Adam Dolder**

Managing Director,  
Great Point Partners

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### 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 the 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.

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 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."

### A Cure for Healthcare?

Adam Dolder

#### Great Point Partners

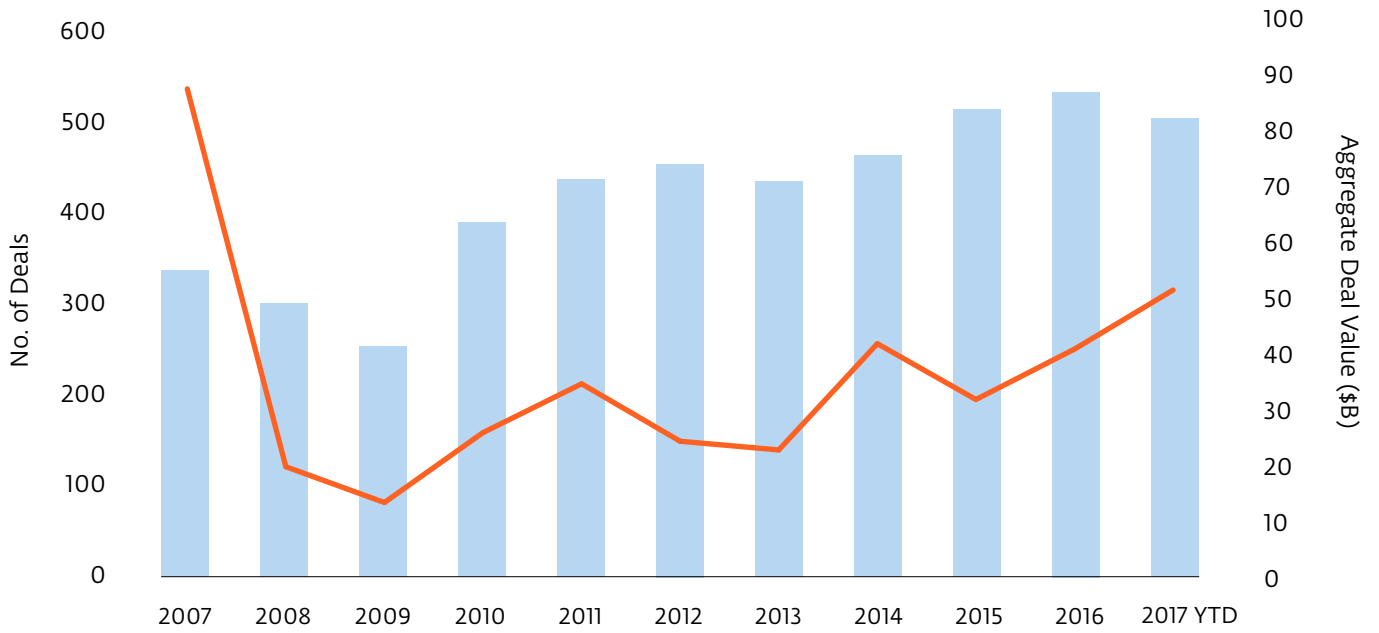
Companies that can remove the veil of secrecy around healthcare and make information transparent will be among the big winners going forward, Dolder thinks.

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."

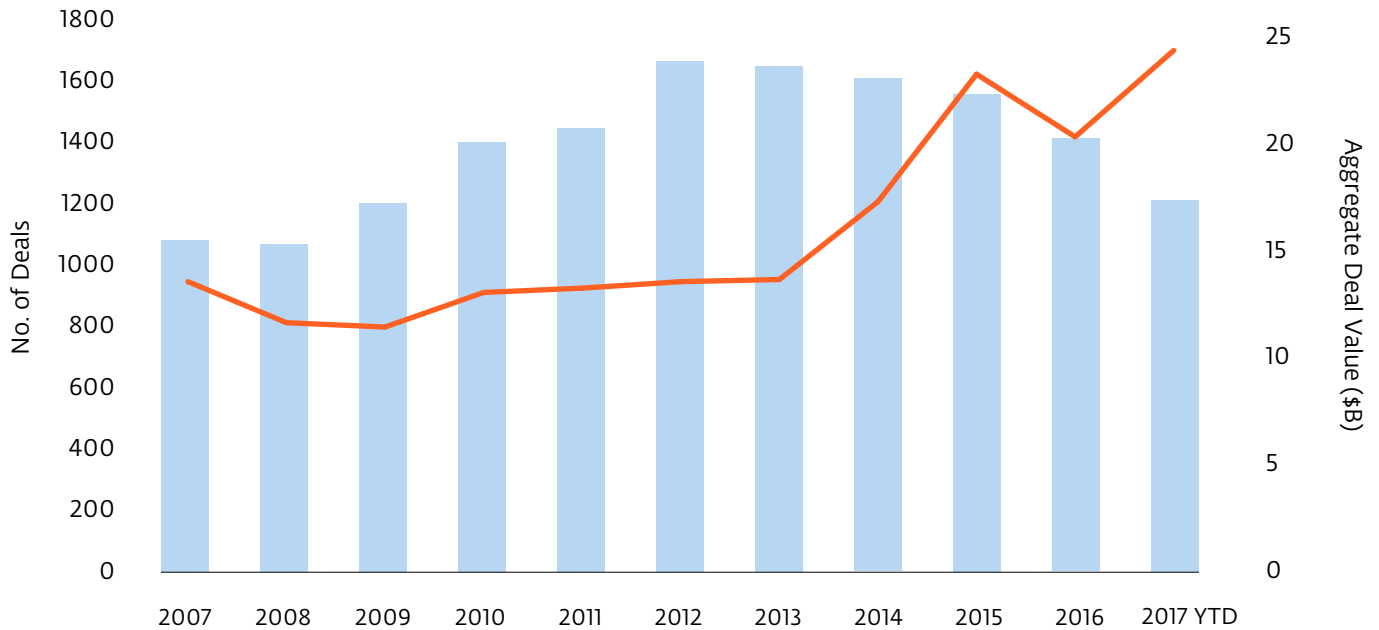
In an ideal world, such a company would let consumers know exactly what they're going to pay for a particular medication—well before they go to the pharmacy. So if the consumer would rather buy the generic version of that drug and pay less, they'd have that option.

"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."

### Private Equity-Backed Buyout Deals in Healthcare



### Venture Capital-Backed Deals in Healthcare



■ No. of Deals      — Aggregate Deal Value (\$B)

Source: 

## 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."

### 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 operations. 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."

"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." ■



# Expert Q&A:

## 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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## Contacts

### Editorial

David Snow / [dsnow@privcap.com](mailto:dsnow@privcap.com)

Matthew Malone / [mmalone@privcap.com](mailto:mmalone@privcap.com)

### Sponsorships & Sales

Gill Torren / [gtorren@privcap.com](mailto:gtorren@privcap.com)

## Investing in Value-Based Care



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