Health and Life Sciences Rx PODCAST

EPISODE 4: CHECKING HEALTHCARE'S PULSE

INSIGHTS FROM THE BDO CENTER FOR HEALTHCARE EXCELLENCE & INNOVATION

INTRODUCTION & BACKGROUND QUESTIONS

Todd: Hi, there. I'd like to welcome our listeners to another episode of BDO's Private Equity PErspectives podcast. My name is Todd Kinney. I'm the National Relationship Director for BDO's private equity practice, and I'm based in New York. Very excited to have two guests with me here today. First, a new and very good client of BDO's, Faruk Amin, who joins us from Juna Equity Partners. Faruk is a managing director at Juna and has experience in sourcing investments, performing due diligence, negotiating terms, and working with portfolio companies with respect to their strategy, financing, and exits. Faruk, we're thrilled to have you. Thank you.

Faruk: Thank you, Todd. Thanks for having me. Juna is a relatively new private equity firm established by a gentleman by the name of Patrick Kocsi about three years ago. It's a spinoff of GE's private equity business. We focus on non-controlled private equity transactions across several different sectors. Healthcare services is one of them. We also do business services, industrials, consumer, as well as media. I'm one the senior deal professionals in the team, and we have six people in the Juna team.

Todd: Great. Secondly, I'm very pleased to have BDO's own Patrick Pilch with us today. Patrick co-leads the firm's Center for Healthcare Excellence & Innovation and has significant experience providing strategy, business transformation, interim management, M&A advisory, restructuring, turnaround, and performance improvement services to organizations and their stakeholders. Geez, Patrick it doesn't sounds like there's much you don't do. Huh?

Patrick: I don't bottle wash.

TOPICS DISCUSSED INCLUDE:

Todd: Patrick, it's great to have you here. As the co-leader of the Center of Excellence & Innovation, maybe you could tell the listeners a little bit about yourself and the Center.

Patrick: Sure. Thank you very much, Todd. I'm happy to tell you the story about the Center and some ideas and things we're kicking around. So at the Center, we see the future of healthcare as a shared-care, shared-value model. And that's where the focus that we're moving towards as we get more into this consumerism model that's happening in healthcare. And what we mean by that is that it's the process of breaking down silos in connections across the continuum of health, life science ecosystems, the companies, I would say the industry's borders as well, because we are getting beyond to more of a global framework to really unlock value, improve patient outcomes, and improve ideally patient experiences. So, at BDO in the Center, we work with healthcare organizations to help achieve that vision by capitalizing on data, optimizing profitability, addressing and managing, helping to manage, risk, and helping them to compete and transform in this new model moving towards value-based payment. And most critically, importantly, is take all the services and capabilities of the firm and help them innovate patient care great.

HEALTHCARE DEAL ACTIVITY

Todd: Great. Great. Well, let's jump into the first topic, kind of broadly, healthcare deal activity. I think we wanted to talk to you about why private equity, and frankly, investors in general, have such a strong appetite for healthcare deals right now. I think if we look at just this summer, KKR's $10 billion acquisition of Envision Healthcare, which is a provider of doctors to hospitals, was really the largest healthcare buyout deal since the financial crisis. So, I guess we'll start with Faruq. And then Patrick, maybe you can comment after Faruq. I guess the question is why is healthcare so attractive to private equity investors today, Faruq? And on top of that, do you see any particularly interesting opportunities within the healthcare middle market? And for this one, let's define mid-market as 10 to 50 in EBITDA.

Faruk: Sure. The market is hot in general right now, but there's been a flurry of activity across the healthcare services spectrum. As you know, we are long into the economic cycle at this point, and the cycle at some point is going to turn. And when it does, healthcare as a defensive sector is probably going to fare a little bit better than some other sectors. Of course, that's not the whole story. There is a significant amount of interest in healthcare also because of the long-term demographic trends that we see in the US. And that's also a very attractive feature for healthcare investors.

Todd: Patrick?

Patrick: Yeah, thank you, Todd. So, I would say also, too, there's a lot of cash looking for homes. And private equity funds certainly have a lot of capital to deploy, and they're going lower and lower, more early stage. And from my perspective, what I see what's happening is that the early stage folks, the smaller companies, are clearly in the mid-market space because of that, and there's momentum behind that. And now firms are approaching healthcare deals as a portfolio play, not just as siloed, "I'm going to go after one particular thematic, whether it's a derm. practice or behavioral health, etc.," but they're looking at thematically how it fits across the healthcare continuum. And as they do that, it's much easier to scale a mid-market than it is to scale an early stage or small, because it just takes a while to get from there to where it is now. And to your point, Faruk, I think that we're going to see more and more of these types of deals. And I've noticed, I don't know if you have, but I've noticed more of the dipping down of private equities to where VC had been in the past.

VALUATION TRENDS

Todd: Interesting. Interesting. All right. Well, why don't we move on to, kind of broadly, valuation trends. I think we all know valuations are sky high within the healthcare space and really beyond. While there are plenty of promising opportunities, some investors are more cautiously pursuing highly valued deals. I guess Faruq, I'll throw this to you and then Patrick. Why do you think valuations are so high right now, and what could be the potential implications on returns?

Faruk: Sure, Todd. Valuation in general in the market is pretty high for several different reasons. Public equities are richly valued. In addition to that, you have a significant amount of capital that has been raised by a lot of private equity funds that are looking for a home, as Patrick mentioned. And so the sponsors are eager to deploy that capital. There's also an abundance of cheap credit in favorable terms. All these factors jack up valuation in the marketplace. Healthcare is also impacted by the cycle issue that we talked about. As a defensive sector, it's garnered even more interest. So, all those factors make the valuation very high. I think what's important is in a specific deal you need to think through what's the growth profile and whether the growth profile justifies the valuation. And also the capital structure that you construct, whether that can withstand a realistic downside scenario. If the growth doesn't materialize for a deal that has a high-entry, multiple valuation as well as high leverage, your returns are going to be impacted pretty severely.

Todd: Some pretty good insight. Patrick, what are you seeing?

Patrick: Well, I certainly agree with the valuation pressures because there is a lot of money looking for homes. And there's two types of investors that we're seeing at a high level, and you can start seeing some of the funds are being raised. There's investors not necessarily with deep expertise in understanding in an industry per se but maybe generalists. But now they're going thematic like, "I want to get into healthcare." And so that's a lot of cash coming in. All right, so we're looking for homes for that. So that's a driver of value. But there are other investors who are really I would call the smart money investors who have deep expertise on their teams, and they see opportunities. And they understand the implications of the investment thesis beyond traditional competitor alternatives or existing products. And this gets into real innovation that really sees where the vision of this organization, this investment thesis could expand beyond the current models.

COFFEE BREAK WITH STEVEN SHILL: CANDID CONVERSATIONS ON ELDER CARE

Todd: Fantastic. And now we'd like to take a quick coffee break with BDO's Steven Shill who co-leads the firm's Center for Healthcare Excellence & Innovation with Patrick. Steven will unpack some interesting findings from the Center's recent Candid Conversations on Elder Care study.

Steven: Hello, my name is Steven Shill and I'm an assurance partner and national leader of The BDO Center for Healthcare Excellence & Innovation, with my colleague Patrick Pilch. As Patrick mentioned earlier, we see the future of the industry as 'Shared Care, Shared Value.' The need to achieve shared care and shared value is most urgent in elder care. In a race against time, elder care providers must curb overall healthcare costs under government pressure, while innovating patient care to meet changing consumer-driven ideas about what senior care looks like. And they must do it amid a growing, aging population.

To meet elder care's urgent demands, providers are placing their bets on home health and technologies that enable it. Our **Candid Conversations on Elder Care** study found that providers are lessening their focus on facility-based models and ramping up investment in models like home health as they prepare for growth of the aging population. They also see home-based care as the top opportunity for tech disrupters to improve elder care by 2020. And, providers' planned investment in home health varies by region.

We think there are three key questions for providers to consider:

Number One: What's behind the regional difference? Of the providers, more than half in the Northeast chose home health compared to 35 percent in the West. It's not what you might think. We think this shows that the Northeast is in large part playing catchup to the West when it comes to evolving traditional healthcare models to lower spending and improve outcomes. In the Northeast, you have the states that tend to spend the most on healthcare and hospital care because of the region's larger portion of elderly residents and higher-profile hospitals, respectively. In the West, you have health systems, like Kaiser and others, which have provided a strong model of how a holistic, well-coordinated health system can keep patients healthy and out of the hospital. Providers on the West Coast may also have adopted home care models sooner than their Northeast counterparts because of their tech-centric economy. This gives them more direct access to innovative technologies that make home health models possible. One way to improve patient outcomes and lower healthcare costs is by moving care from the hospital to the patient's home, through telemedicine, sensors and wearables, and in-home geriatric caretakers. So, while the West figured out this model years ago, we think the Northeast is upping its investment in the space to catch up.

Number Two: What does this mean for software companies that provide telemedicine tools and other platforms that support home health? With the expansion of telemedicine reimbursement and the race to contain healthcare costs, we expect demand for these platforms to increase. Providers need platforms that enable the use of telemedicine in conjunction with remote monitoring of vitals and wearables. But it's important to keep in mind that many elders are not familiar with new technologies and might find devices overwhelming. So educational and other support services, to help them get comfortable with such devices, are needed. Because much of this technology requires R&D, there is an enormous incentive for software developers to work towards credits from the IRS and state taxing authorities to help finance the development of new telemedicine and other digital health technologies. Private equity firms and venture capitalists are actively looking at these companies because they provide innovation, which in turn contributes to lower healthcare costs. This is especially good news for the West Coast, which is ground zero when it comes to software development, whether it be Silicon Valley or Silicon Beach.

Number Three: What does the shift away from facilities-based models and towards home health models mean for traditional elder care providers, like skilled nursing facilities and long-term acute-care providers? Under consumer-centric high-value care, SNFs and LTACs that evolve business models to improve care quality and satisfaction, boost population health and reduce healthcare costs, will thrive. In the Northeast, this means refocusing service offerings and expertise to align better with in-home health models, in tandem with providers' growing focus there. In the West, where providers said their top segment of investment would be in geriatric caretakers, this means evolving service offerings and bolstering recruitment in geriatric specialties.

Looking ahead, we not only expect to see increased focus on quality over quantity in elder care by 2020, but also in the longer term. Healthcare providers will focus senior care more on preserving independence for longer and they'll look to technologies—like Apple's recently unveiled watch with a heart sensor—to do it.

Todd: Thanks, Steven. And now back to our conversation with Faruk and Patrick.

HEALTHCARE'S DIGITAL TRANSFORMATION

Todd: Guys, let's jump onto the next topic. Venture capital interest and investment in health tech is increasing in markets worldwide certainly. Patrick, let's throw a two-part question out to you. Are there certain kinds of digital capabilities that modern healthcare companies need to be successful? And how do you think healthcare companies can integrate technology successfully?

Patrick: Sure. So, answering the first question, one of the key success factors we're seeing in healthcare is certainly the ability to capitalize on data. And data has to be clean data as we talk about it, as we refer to it. So, we see companies beginning to leverage their own data to ensure sound information governance. And understand what data lives in your house is crucial to any company's progress, right? So, think about deploying the technology with that to strengthen the information governance is always a great first step. Controlling the asset-- the data is an asset. And beyond that integrating digital services associated with that that strengthening the accuracy of audit, financial reporting is also key, but especially as maximizing or optimizing profitability becomes more important amid healthcare transformation because we are kind of moving to an analog world to a digital world. And so this transition's going to be pretty powerful. And at the same time, companies also need to make sure that they have threat-based cybersecurity processes and controls in place, meaning they need to protect their patient data and privacy but also along with their intellectual property as well, their own IP. The final step to capitalizing on data is actually the most advanced, and this is where companies incorporate tech like real-time data analytics, artificial intelligence, and machine learning to support precision medicine. Precision medicine ultimately is kind of where we're looking towards, working towards, and remember in the past innovation in healthcare meant we're going to continue to sustain the model. Where we're going right now is we're not sustaining the model. We're breaking it, disrupting it, but in that disruption and transformation, there's a lot of risk associated with that. So, these are kind of the recipes for preparing companies for that movement.

Todd: Good stuff, Patrick. Very impressive. Faruk, I'll turn this one to you. I guess we know that Juna has improved many of its portfolios companies' operations by enhancing their digital capabilities, particularly with data analytics. Within the realm of healthcare, what kinds of technology do you think will be critical for PE owners to integrate into their healthcare portfolio companies to really ensure success?

Faruk: Sure, Todd. Healthcare, as you know, is transforming from fee-for-service to value-based care, which requires much more sophisticated patient knowledge. Making complex health data useful and actionable is a real challenge. Current manual processes can't do the job well and are often prone to accuracy challenges. So, technology will play a big role in providing the solutions. One of our portfolio companies is a SaaS healthcare company that provides risk and quality solutions for value-based care and has payers and providers as its customers.

THE FUTURE OF HEALTHCARE

Todd: Okay. Great insight, Faruk. I hope you guys both brought your crystal balls today. Patrick, is that what's in your pocket there?

Patrick: I do. I have it right here. It's in my pocket.

Todd: Yeah, okay.

Patrick: That's why it's very uncomfortable.

Todd: Faruk, you got yours?

Faruk: Yup.

Todd: All right. This is where we get into the future of healthcare. Quite a few massively significant deals and disruptive forces are on the horizon from Amazon's emerging healthcare arm to the pending CVS-Aetna deal. Patrick, I'll throw this one out to you. So, what should healthcare investors and healthcare companies expect in terms of deal activity and disruption really within the next year or so?

Patrick: Sure. So, Todd, I would say let's take a step back and look at where the value-based payment or value-based care movement is going. It's really going to very transformational. And also, actually have a restructuring impact on the healthcare industry. There's a lot of literature out now on the market that talks about this. So, certainly, there's going to be a lot of disruption, capital shifts, realignment of assets, etc. This is going to create some huge challenges for companies. But also, certainly some tremendous opportunities. But I do think the real major change and opportunity comes down to two words. Digital transformation. It's so much more than an organization's front-end capabilities and communication in terms of clinical interfaces with consumers of healthcare services and the consumer engagement we so enjoy in other industries. But also at the back end. So, let's think about the frontend being very much digital. If your backend is very much analog you have a misaligned organization and not as efficient as it can be. So, companies really need to understand out to become a truly digital healthcare organization. I think that's where there's tremendous opportunities for investment. I think in creation of value. I think that some of these companies that have great run-ins in terms of analytics on patients, consumers of healthcare services. But they have to go back to the back of the house if you will. The finance office strategy. It's really dated. It's living in another century sometimes. So, we need, from an investor perspective, to understand how these digital capabilities need to be consistent throughout the business so that they'll--there needs to be certainly a shift in mindset around what to look for in healthcare companies. If you're coming in as an investor and the front-end is very digital, the back-end is not, there's your transformational opportunity and you can add a lot of value. It would be an incredible opportunity to invest in a company, however, that creates the whole front-end and back-end digital solution for healthcare organizations. I think that's where there's a tremendous opportunity there.

Todd: Awesome. Lots of tips and insights for our listeners. Faruk, what do you foresee for the healthcare industry and private equity investors in the space?

Faruk: Yeah. I agree with Patrick. There's no doubt that massive digital transformation is occurring across all industries, not just in healthcare. We think that machine learning, and artificial intelligence are also likely to have a massive impact in the global economy and all the businesses. Particularly, in regards to the size and structure of the workforce. So, when you make an investment you have to think through the implications of these changes. In terms of deal activity, I expect healthcare IT, physician practice management, as well as behavioral health care, continue to be very active subsectors for mid-market private investors.

Todd: Fantastic. Well, guys, again, Faruk Amin with Juna Equity and Patrick Pilch with our Healthcare Center of Excellence & Innovation. Thank you, both, for taking the time to join our show today. I know our listeners are really going to enjoy hearing about your experiences and insights and predictions for the future. We'll come back in a year and see if you guys were right.

Patrick: Sounds good. Yup.

Todd: Faruk, you game?

Faruk: Thank you.

Todd: Awesome. All right. Well, to our listeners, thanks so much for tuning in. If you haven't already, we'd love for you to subscribe, rate, and leave a review of the show on iTunes. Until next time, all my best. Take care.

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CONTACT:

PATRICK PILCH
Managing Director, National Leader
The BDO Center for Healthcare Excellence & Innovation
212-885-8006 / ppilch@bdo.com

STEVEN SHILL
Assurance Partner and National Leader
The BDO Center for Healthcare Excellence & Innovation
714-668-7370 / sshill@bdo.com

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