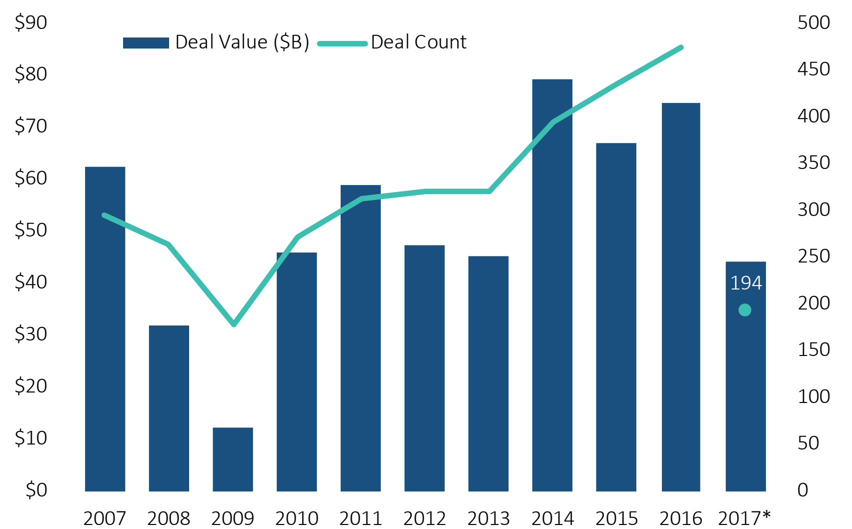
Managing PE Portfolio Healthcare Costs in An Expensive Climate

The private equity landscape in the US remains complex, marked by high valuations and consistently elevated investment volume. Healthcare is no different, with vibrant investor interest in niche segments such as behavioral health and process management software. PE activity in the US healthcare sector reached a peak in volume last year, with 474 completed transactions for an aggregate of close to $75 billion in value.

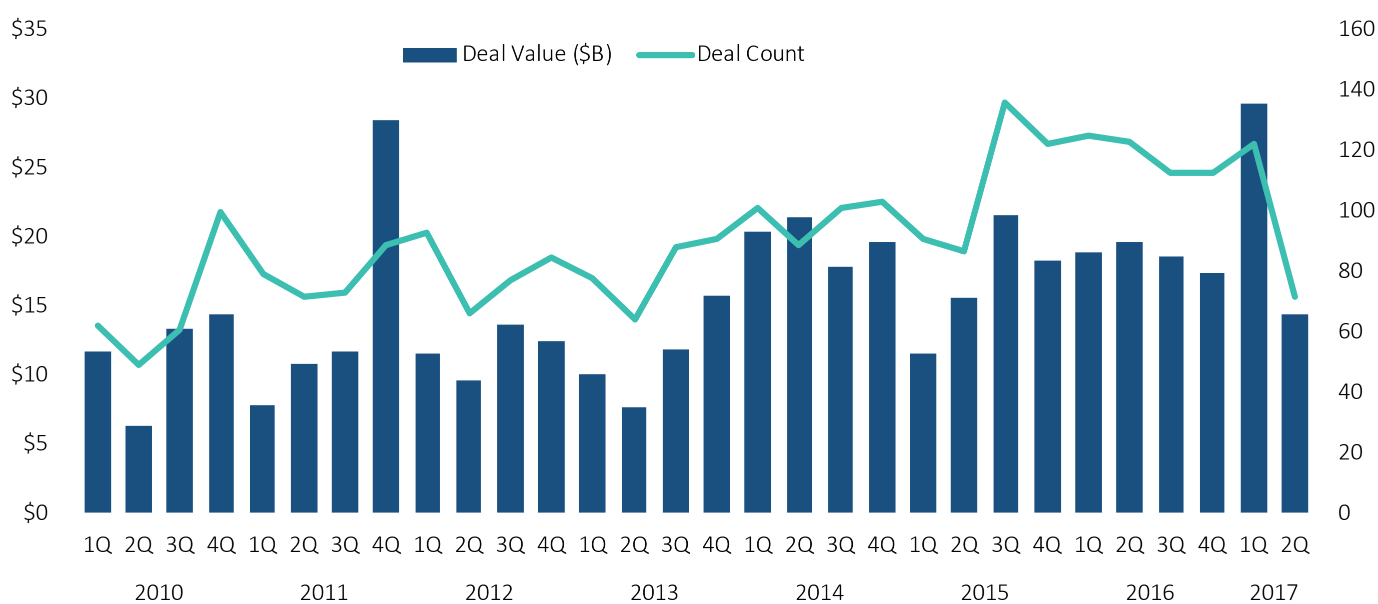
Revenues are climbing steadily, with a peak last year among US healthcare businesses per PitchBook datasets, but that may be more attributable to the fortunate economics of the industry, although given consolidation many organizations have been forced to become more efficient and focused on the bottom line.

PE activity in US healthcare by year



Source: PitchBook
*As of 7/17/2017

PE activity in US healthcare

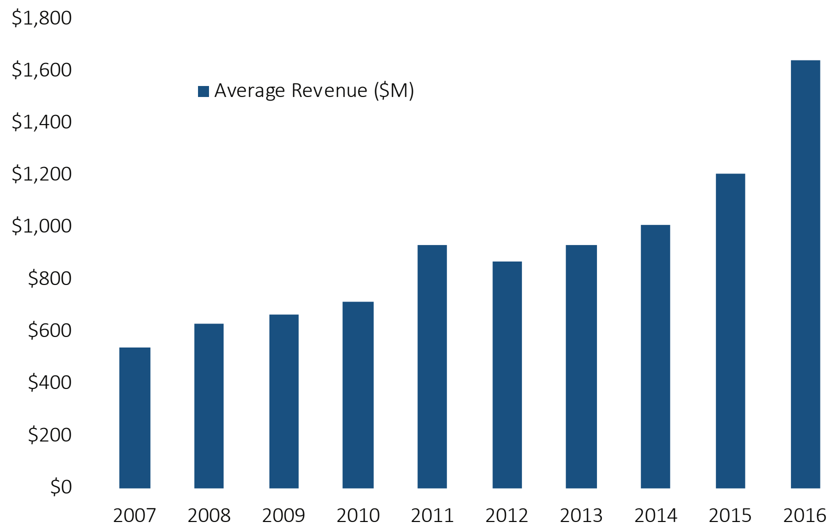


Source: PitchBook

For healthcare portfolio companies such as providers—one of the more hotly contested spaces for M&A currently—the emphasis on claim controls is the feature to note. Particularly given the rapid expansion in the ranks of those insured in the US over the past few years, and how challenging timely reimbursements can be, ensuring claims are minimized is critical. Additional factors PE-backed healthcare providers can focus on include the ancillary services that can help mitigate costs, such as automation of back-office processes.

While gaining exposure to a thriving sector with potential for significant profits due to cost structures and expanded populations of consumers, private equity buyers must manage costs among their existing portfolio companies assiduously as they look to close deals. Private equity firms can afford to contract premium plans for their portfolio companies, which, combined with aggressive claim control mechanisms, can lead to savings. Interestingly, as sample UnitedHealthcare® data shows, savings are correlated to high engagement. Accordingly, PE firms looking to reduce their healthcare spend across their portfolio businesses in general should encourage utilization of care of greater quality. For most PE-backed portfolio companies, the cost of healthcare benefits is second behind payroll in the largest expense to the firm. Combining an aggressive healthcare claim control strategy with a healthcare aggregation strategy can drive an increase in value for the PE firm for their investment.

Average annual revenue for US healthcare companies by year



Source: PitchBook

Sample coalition of PE portfolio with aggressive claim control mechanisms

METRIC	LOW ENGAGED	HIGHLY ENGAGED	VARIANCE
Claim Risk Adjusted Covered PMPM	$239.45	$200.92	16.1% lower
ER Visits per 1000	201.0	132.0	34.3% lower
Inpatient Admits per 1000	73.9	54.3	26.5% lower
Inpatient Days per 1000	248.0	165.7	33.2% lower
Readmission Rate	4.2%	2.5%	1.7% lower
Pharmacy Covered PMPY*	$1,797	$1,369	23.8% lower

Source: UnitedHealthcare

1. Low premium provider utilization = members with less than 75% of all eligible charges for premium providers
2. High premium provider utilization = member with 75% or more of all eligible charges for premium providers

Represents only continuously enrolled subscribers and spouses, excludes catastrophic cases exceeding $100,000. *RX membership.

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