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Lead Left Interview – Rod Rivera and David Baker

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This week we chat with Rod Rivera and David Baker, Managing Directors at Capstone Headwaters. Capstone Partners LLC and Headwaters MB, LLC recently announced a strategic transaction combining the two firms. This single platform has 150 professionals, covering 16 dedicated industry groups, spanning 20 offices across the US, UK and Brazil. This combination has resulted in one of the largest independent investment banks in the US. Mr. Rivera and Mr. Baker cover healthcare for the firm.

The Lead Left: *Gentlemen, we appreciate a few moments with you today. Given our recent series on healthcare, we thought our readers might appreciate hearing your thoughts on the state of the sector. Perhaps starting with things you believe healthcare investors should be focused on.*

Rod Rivera: Thanks, Randy. It's great speaking with you. First, I would say that increased risk is one of the primary concerns we consider. 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 guys anticipating the change or are they bidding properties up because they can leverage it?

David Baker: 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. For example, Leapfrog Group, Health Transformation Alliance and, recently, The JP Morgan/Amazon/Berkshire venture. These self-insured payors combine resources and use scale as leverage to lower costs and seek innovation in care delivery.

TLL: *We mentioned the recent Walmart/Humana tie-up in our commentary. What's your take on that?*

DB: Most of the news articles repeated stuff everyone already knows about retail and healthcare. But one aspect at the end of one piece caught my eye. Walmart has contracts with fifteen different health systems for procedures such as cath-lab and orthopedics. They contract with each center at a fixed price, and then tracking post-procedure quality. This set-up drives value for Walmart.

RR: It's also not just about volume driving prices down. This is a cradle to grave business. You go from surgery to physical therapy to be able to drive better results. All the traditional information technology from service providers starts to converge around managing the population and comprehensive treatment around costs. As a result, you get better costs and pricing for the system and higher quality outcomes. You need to be strategic as a provider, not just tactical.

TLL*: The role of technology seems to be one of the biggest variables.*

DB: Since human capital is such a large part of cost of healthcare delivery, you need to bring in technology to lower costs. There needs to be an increasingly large component of technology. It used to be the system paid higher costs for better outcomes. That's changed. Now, lower costs always need to be part of the package. Technology provides opportunity to conduct analytics to lower costs, such as, population health analysis,

pharmacogenomics, or even mobile health devices.

TLL: *How are costs and service connected?*

RR: Risk is reduced in a fee for service environment. 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?

DB: Pricing and access to service are the two main levers payors have to control total spend. CMS [Centers for Medicare/Medicaid Services] in the US has tried to keep price increases down but allow access. Other markets, the UK, for example, focus more on access. The result is that waiting times go up.

To be continued the week of May 21

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