Value-based care emerges as must-have for investors

This theme is being embraced by investors across the spectrum and could be a boon for payors, providers and, most importantly, patients.

By **Sarah Pringle** - 5 hours ago PE Deals

The American healthcare system is on the brink, with an aging populace, structural frailties laid bare by covid, and unchecked cost escalation.

Will the answers come from private or public investors funding innovation? Incumbent players, the government, or some combination? One concept taking off that incorporates all these stakeholders: value-based care.

Value-based care (VBC) is an alternative to the historical fee-for-service (FFS) model of healthcare reimbursement. It means transforming the payment model such that the healthcare provider – the physician, for example – is paid not by volume and the types of procedures, but is compensated for the quality of care – a more coordinated, appropriate approach.

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> ***Jon Swope, SVB Leerink***

The idea is that everyone wins. Patients are rewarded with better care, as evidenced by fewer hospitalizations and reduced mortality rates; the payors are happier because they see substantial savings; and as providers are less bogged down with billing and more engaged with patients, retention goes up.

In healthcare, "it's rare that you see that," says Robbert Vorhoff, managing director and global head of General Atlantic's healthcare sector. "Combine that alignment and strength of value proposition with a lot of excitement around the market being massive. In addition, particularly for healthcare investors, there is a

Robert Vorhoff, General Atlantic

big motivation around societal impact. The greatest opportunity for improvement lies with those patients most in need and least well served by the traditional [fee-for-service] delivery infrastructure."

"Value-based care cuts to the heart of the revenue models of the system, which have over the last 40-plus years shown unsustainable growth in medical costs," says Jon Swope, senior managing director of investment banking at SVB Leerink, where he leads the firm's Digital Health & HealthTech practice. "Value-based care seeks to tie together costs and outcomes in a way that benefits all the stakeholders – payor, provider and consumer."

This framework has been long in the making. The ACA regulation during the Obama Administration helped pave the way, and over the last several years the Centers for Medicare & Medicaid Services (CMS) promoted its commitment to value-based care. Adoption has been slow, but these models have sequential tailwinds all coming right now, led by the fast adoption of Medicare Advantage. (In 2021, 42 percent of Medicare-eligible beneficiaries are enrolled in a Medicare Advantage plan, which leaves significant potential runway.)

> *"When you look at value-based care and companies that seem really successful – well they are, but are they successful because they are reducing the cost of care per patient? It's hard to tell when they are growing so fast."*
> ***Nick Richitt, Deutsche Bank***

Value-based care is an inexorable trend that will broadly benefit the entire industry, according to Ezra Perlman, co-president at Francisco Partners. "There's no other market where trillions of dollars of spend are going to be fundamentally rethought, re-evaluated and redefined over the coming 15 or 20 years," he says. "There's lots of good reason to be increasingly excited about the segment, but it's that excitement that can lead to exuberance and overvaluations in both public and private markets."

As Perlman sees it, the evolution of value-based care is not unlike the e-commerce and internet investment bubble of late 1990s and early 2000s.

Ezra Perlman, Francisco Partners

"In many ways, e-commerce has fulfilled all of the expectations. It has grown tremendously and is now enmeshed in everything we do. Some of those companies wound up being incredibly successful and are now worth trillions of dollars or hundreds of billions of dollars. There were plenty of other bankruptcies and failures along the way, and lots of other companies have pivoted, changed, muddled through, and done okay," he says. "I think many of those things will be true of value-based care."

Another trigger for the rush of activity? Payor and provider convergence. A decade ago, explains Kara Murphy, partner at Bain & Co, "the absence of all the data and tools to enable value-based care was a gap. The ability to succeed against that vision is becoming increasingly high in terms of stakeholder alignment."

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Healthcare is one of the few – if not the only – offensive and defensive segments from an investment standpoint, adds Andrew Adams, co-founder and managing partner of Oak HC/FT. "We're wasting a trillion [dollars] a year and have an aging population, so there's going to be growing consumption, but because of that, there's a need to invest in these new modern approaches to managing that spend."

A true growth market

Jon Swope, SVB Leerink

Until recently, public market investors had few places to park their money in high-growth healthcare businesses. Virtually nonexistent a year ago, the combined market capitalization of recently emerged value-based care companies now totals almost $60 billion of the $1.3 trillion healthcare market, says Leerink's Swope.

The growing public ecosystem comprising many private equity, growth equity and venture capital-backed players includes innovative provider platforms like Oak Street Health, Cano Health, InnoVage and CareMax; tech-enabled VBC models such as Agilon, Privia Health and Babylon; and emerging payors like Bright Health, Alignment Healthcare, Clover and Oscar.

"You have had this massive mismatch against the public equity investment universe; if you wanted to invest in value-based care, you bought Evolent's stock; there was nothing else to buy. There was a lack of supply of investable names," says David Caluori, a general partner at Welsh, Carson, Anderson & Stowe.

David Caluori, Welsh, Carson, Anderson & Stowe

The private markets are delivering mega-investment rounds into these models. Notably, SoftBank, in September, reportedly invested $400 million in Medicaid-focused CityBlock Health at a valuation of $5.7 billion. Elsewhere, Medicare Advantage insurance startup Devoted Health in October raised $1.15 billion, led by Uprising and SoftBank, pushing its valuation past $12 billion, MedCity News reported.

Because the transformation taking place is growth-oriented, in Caluori's eyes, the capital needs for innovative businesses in value-based care "are greater than what history has usually required these businesses to have."

Mandar Vadhavkar, a senior managing director at Guggenheim Securities, says the pandemic added more fuel to the fire. For providers, it woke many up to the fact that there must be a better model for them to pre-emptively or proactively keep the patient healthy. "That realization has set in" for those "historically resistant from moving from fee-for-service to value-based care."

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modern approaches to managing that spend."

Andrew Adams, Oak HC/FT

"The technology investors that have been flooding these markets with their dollars – that's one of the factors driving innovation," says Vadhavkar, who focuses on advising companies in healthcare services.

Mandar Vadhavkar, Guggenheim Securities

"You will see promising technologies and breakthroughs in the sector which will take us to the next level in healthcare services, which will actually solidify and institutionalize value-based-care for the decades to come. Combine that with general liquidity in the marketplace and the fact that we're living in a very low-rate environment – you can see that it's an extraordinary opportunity."

Build-for-purpose

Private equity and growth equity shops are placing their bets behind young companies and entrepreneurs, hoping to get in early to capture value-creation. That strategy has worked out undoubtedly well for some, with the first generation of models largely focused on primary care (and others in post-acute care).

Consider Cano Health. Investing behind a modest two-location platform five years ago, New York-based private equity firm InTandem Capital Partners injected an initial $30 million into a South Florida operation with a vision of becoming America's primary care.

"I don't think there are that many other investors – no matter how interested in value-based care – that would [invest at that size]," says InTandem founder and managing partner Elliot Cooperstone, who about seven years ago began developing a thesis around what later became Cano. Starting at that scale, Cooperstone says, allowed InTandem and the leadership team, led by Marlow Hernandez, to mold an organization to fit what it aspired to ultimately become.

Today, Cano spans 113 risk-taking primary care centers serving seniors across the country. The company this June completed one of the largest announced healthcare SPACs of 2020 – merging with Barry Sternlicht's Jaws Acquisition at a $4.4 billion enterprise value. Its market capitalization sat at approximately $5.3 billion as of October 29.

"We had a very clear imperative from the very first day – deliver the best outcomes to seniors' Medicare Advantage plans. It was simple and elegant and clear; delivering on that imperative is very difficult... That wonderful flywheel really started to spin once we could publish outcome data," says Cooperstone.

Elliot Cooperstone, InTandem Capital

"Operating at scale [and with density] is the only way you can support the infrastructure necessary to be a successful risk-bearing entity, and operating a value-based model at scale is increasingly difficult. Technology is also a necessary tool for providers to operationalize a

value-based care model such that the data you have that mastery over turns into insight, which then turns into prompts for action."

Elsewhere, WCAS has experienced the advantages of starting from scratch and is using that knowledge to assemble a growing portfolio of early-stage VBC bets: CenterWell; a joint venture with Humana; CareSource; Valtruis; Rubicon Founders; and InnovAge, which it owns alongside Apax.

"Right now, the edge in investing in healthcare is more in the barbells," Caluori says. "It is about getting in early when you have the ingredients for success – management, customer access, an enforceable model and access to capital. If you can get those ingredients together earlier and you own a big piece of the company, then you can create some unique value."

That's the puzzle that WCAS is looking to solve in committing $300 million to Valtruis, a value-based platform that has so far partnered with two early-stage companies – in-home addiction treatment platform Wayspring and kidney care provider Cricket.

"We were very successful starting a company like naviHealth (a post-acute VBC enabler, now owned by UnitedHealth's Optum) 10 years ago; if we get this right, the next naviHealth in that analogy will come out of Valtruis because we've created this ecosystem in value-based care."

If this strategy sounds familiar, it's because WCAS also recently partnered with entrepreneur Adam Bohler, the former CEO of Francisco- and GA-backed Landmark Health, to invest alongside Rubicon Founders – another entity aiming to build transformational VBC companies. Likewise, the former CEO of Oak HC/FT-backed Aspire Health, Brad Smith, launched Russell Street Ventures earlier this year. These ventures follow Frist Cressey Ventures, which former Senate Majority leader Bill Frist and Bryan Cressey launched in 2016.

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>
> ***Brad Hively, The Oncology Institute***

With proof points increasingly emerging, VBC is at a unique moment, says Mohamad Makhzoumi, managing general partner at NEA. In his eyes, the early-stage investment activity occurring today is a by-product of where VBC is in the innovation cycle.

"The category is so young that there aren't a lot of fee-for-value companies generating $200 million of EBITDA a year that make them prime targets for the buyout crew. If you want to play that theme, whether a public investor, growth equity investor, traditional buyout firm or venture – you have to go earlier in terms of size and stage," says Makhzoumi, whose firm's umbrella of VBC investments include the likes of Bright Health, AllyAlign Health and Strive Health. "As these graduate, we will start to see more buyout types trying to get involved."

GA's Vorhoff expects to see more traditional large buyout activity around scale fee-for-service models where investors not only are going to apply financial leverage to generate returns but making a bet that they can transition at least some of that company's patient population to a value-based construct.

Consider Altas Partners' recent acquisition of Ares Management-backed Unified Women's Healthcare – an investment opportunity that sources identified as a long-term play on both primary care and value-based care.

Women's health lends itself well to value-based arrangements because obstetrics itself is a very discrete episode of care. That presents an opportunity to share risk and savings with payors. At the same time, many women – including a large portion of the Medicaid population – consider their OB as their primary care physician. OBs have access to a lot of outstream spending – whether that's in urology or cardiology – and thus payors view women's care and the OB as a critical part of the network.

Perlman says Francisco Partners would invest in another value-based care model, but finding one that checks all of its boxes has become increasingly difficult as the competitive dynamics remain hard to predict. The two things Francisco looks for in every investment: long-term differentiation and a quality team with an ability to execute.

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"Many of the companies that we have seen more recently have been okay-to-good on those axes, but the sustained competitive advantage or differentiation is harder and harder to come by. It was really novel when we invested in Landmark," Perlman says. "The bar has gone up given how the sector has evolved."

The founding vision for Landmark, says Perlman: go after the sickest, most complicated and expensive population, and apply the principles of value-based care.

That's where Perlman felt Francisco could have the most impact: "I think focus has had a big benefit, and Landmark was laser-focused from the very beginning on a very specific patient population – where the spread of outcomes or savings was much greater than in many other areas."

Meshing old with new

The sale of Landmark earlier this year underpins another driving force in value-based care: The established stakeholders in healthcare aren't sitting on the sidelines.

UnitedHealth's Optum unit bought Landmark from Francisco and GA earlier this year, and in 2020, it acquired CD&R's naviHealth at a $2.5 billion total enterprise value. All this while OptumHealth's own value-based primary care network, OptumCare, keeps growing.

Humana, meanwhile, partnered in 2020 with WCAS to run a network of senior care VBC centers under the CenterWell brand. It has separately built out its senior-focused primary care network Conviva.

The large payors, Guggenheim's Vadhavkar says, are focused on vertical integration and margin improvement and growth, largely by building out

technology, payor delivery models, provider networks and more efficient data analytics engines.

“PE has embraced the payor-provider convergence wholeheartedly,” Vadhavkar says. “They want to put more money to work and create those platforms that are going to be very attractive to these big payors as they try to lower the cost curve across the healthcare system.”

The legacy players have invested decades into infrastructure, which can’t be ignored, adds Oak HC/FT’s Adams.

“In delivering care, you have to work in a regulatory framework that exists. Whether that’s a claim or payment flow – how do you augment that or evolve that to fit a value-based construct? I think that’s what creates a lot of opportunities out there.”

Adams points to Oak HC/FT’s investment in data automation company Veda as an example on the payor side, or Olive on the health systems side. “These are very modern approaches, but with a full appreciation for the infrastructure that they’re walking into at a hospital or a managed care company.”

Other incumbents like Walgreens are flexing their muscles in and around value-based care. More than doubling its existing stake, the pharmacy chain in mid-October made a $5.2 billion investment in Oak HC/FT-backed VillageMD, whose technology helps affiliated primary care doctors adopt a value-based model of reimbursement.

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Data-enablement

Incentives are arguably the primary driver of value-based care. But that “enabling engine” for value-based payments, as Adams puts it, underscores a bigger theme. Nick Richitt, who co-heads global healthcare investment banking at Deutsche Bank, points to another essential piece for value-based care to work in the long-run: data liquidity.

“When you look at value-based care and companies that seem really successful – well they are, but are they successful because they are reducing the cost of care per patient? It’s hard to tell when they are growing so fast,” Richitt says.

“To advance value-based care, health plans need data. I do not believe they have gone to the level of data liquidity that would provide a much-heightened level of data transparency, with real-time notifications so that you can really, really do value-based care.”

A few companies fit that theme, Richitt says: PatientPing, Audacious Inquiry and DataVant.
Consider PatientPing (recently acquired by Clearlake Capital- and Insight Partners-backed Appriss), which provides real-time-notifications across different healthcare constituents.

Says Richitt: "If you're a payor or a risk-taking provider, you want to know if your patient is at a hospital, you want to know when they are discharged, and you want to know if all of a sudden, they show up in an emergency room, right?"

Data connectivity, he explains, is knowledge that can ultimately be used to save costs, whether that's by lowering hospitalizations or preventing unnecessary procedures and tests.

At a later scale, DataVant effectively de-identifies patient records – stripping any information that can be used to identify an individual – but then collates these sanitized records using a proprietary index to see a single patient across various sources.

"They've just done all the hard work of linking it all together and making it [useful]," says Richitt. DataVant recently merged with New Mountain Capital's Ciox Health, with the $7 billion combination adding Sixth Street and Goldman Sachs Asset Management as investors.

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> ***David Caluori, Welsh, Carson, Anderson & Stowe***

SVB Leerink's Swope agrees. "You need a real-time understanding of how the care decision will impact the financial reimbursement outcome," he says.

"There is a lot of work to be done seeking to connect the dots. The democratization and liberation of data in healthcare is a key in value-based care models."

Swope points to Hellman & Friedman-backed PointClickCare and recently acquired Collective Medical Technologies, another company providing real-time notifications between stakeholders.

"What that combination seeks to do through data and tech-enablement is drive information sharing across the post-acute spectrum. It's certainly the case that other healthcare IT vendors like WellSky and Netsmart are also oriented towards the same innovation around post-acute value-based care enablement. The next frontier for value-based care is post-acute."

Three waves

Primary care – coined the quarterback of healthcare – has led the charge in value-based care, and for an obvious reason: these groups are not well-reimbursed under fee-for-service models.

"There's a ton of runway in primary care," Oak HC/FT's Adams says. "Within the context of populations, you have urban, rural, Medicare, Medicaid, commercial, young and healthy – that's an enormous market. You could have a company dedicated to those five areas across many local geographies."

"The horse is out of the barn and that will continue to accelerate," adds InTandem's Cooperstone.

> *"There is a big motivation around societal impact. The greatest opportunity for improvement lies with those patients most in need and least well served by the traditional [fee-for-service] delivery infrastructure."*
> ***Robert Vorhoff, General Atlantic***

And while a vast majority of the primary care market remains fee-for-service, a second wave of value-based care is beginning to take shape, as evidenced by The Oncology Institute (TOI). The PE-backed cancer care company in June agreed to merge with a SPAC sponsored by Deerfield Management and veteran healthcare executive Richard Barasch – marking the first and only specialty VBC company poised to go public.

"To me, there's going to be three waves of value-based care," TOI CEO Brad Hively told *Buyouts* in June. "Primary care has led it; that's the first wave. The second wave we've kicked off with specialty value-based care. The facilities will be the third to come onboard."

The reason the specialty care providers have lagged? They don't have the same incentives because many are already well-reimbursed under a fee-for-service model.

That said, for an at-risk primary care business, InTandem's Cooperstone says, managing costs for areas of care that you don't control directly is both a huge risk and huge challenge. "Part of the value-based primary care provider's responsibility is to manage that care that goes on outside of the areas you control."

Hence, as Barasch puts it, specialty value-based care is an outgrowth of primary care growth. "What we're seeing in TOI is a ton of interest from the primary care providers to take some of their risk."

Dealmakers' eyes are on the future, too. While specialty value-based care sits where primary care was 10 years ago, the need and appetite for others to follow suit is obvious, says Guggenheim's Vadhavkar: "We are in a world where the specialties continue to grow from a spend standpoint rapidly – and this includes cardiology, oncology, orthopedics, nephrology, behavioral, women's health and fertility. All of these are massive spends across the board and are a huge challenge for the payors to take the cost down."

Green shoots are emerging, with many new companies around big spending areas scoring investments in categories like kidney care, which includes the likes of Monogram, Strive, Somatus and Cricket. Elsewhere, there's orthopedics-focused HopCO, backed by Linden Capital and Frazier Healthcare Partners.

"If you're an investor and you're only going to make one or two investments in healthcare, you're going to want to do something in Medicare Advantage primary care risk; that's why the valuations are where they are," Caluori says. "We like the idea of building more of these specialty population risk models because we think less people are focused on it right now."

That leaves a third wave that investors are waiting on: the health systems.

"The big question in my mind," GA's Vorhoff says, "is how much of the health system market really chooses transition with a commitment to value?"

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Hospitals today are incentivized to optimize revenues by filling more beds, performing more procedures, and bringing in more specialists to cover their fixed costs.

“Their incentives are very much rooted in a traditional fee-for-service world,” Perlman says. “In order to really improve cost and transparency and quality in healthcare, we need those hospitals to share in the incentives to drive better preventive care, to help drive patients to lower-cost places, to get people out of the hospital sooner and faster.”

Or, as the Hippocratic oath states: First, do no harm.