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ASSET-LIGHT AND READY:

PHYSICIAN GROUPS EMBRACE ACCOUNTABLE CARE

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Market Corner Commentary
for May 11, 2016

HOCKEY SUPERSTAR WAYNE GRETZKY GAVE THE BUSINESS WORLD ITS MOST OVER-USED STRATEGIC METAPHOR, *"I SKATE TO WHERE THE PUCK IS GOING TO BE, NOT WHERE IT HAS BEEN."*

In healthcare, companies are chasing dozens of "strategic pucks" to position for post-reform success. Gretzky would surely disapprove. There's only one golden puck, and it's called value: delivering better healthcare at lower prices with greater convenience.

DuPage Medical Group (DMG), the largest independent physician group in Metropolitan-Chicago, illustrates how value-based care provision is transforming and improving U.S. healthcare. DMG is an asset-light company that delivers high-quality, efficient, patient-centric care. Their physician-led business model is well-positioned for taking health insurance risk and managing the care of large populations.

Moreover, DMG is poised for growth. In December 2015, DMG entered a strategic partnership with Summit Partners, which acquired a minority stake in DMG's practice management company, DMG Practice Management Solutions/MPAS (Midwest Physician Administrative Services). The $250 million recapitalization is a combination of debt and equity. This t ransaction was notable for two reasons:

- Unlike many medical groups that have sold to health systems or insurance companies, DMG believes it will be more competitive as an independent, physician-based company.
- As growth equity investors, Summit believes that DMG's business model and orientation offer enough potential upside for their participation as a minority owner.

The DMG-Summit partnership heralds a new chapter in post-reform healthcare. Asset-light health companies like DMG are winning marketshare by delivering better outcomes, lower costs, greater convenience and superior customer experience. Their ability to attract private equity capital drives growth and accelerates market evolution toward value-based care.

THE RISE OF ASSET-LIGHT COMPANIES

In an industry burdened by overinvestment in high-cost infrastructure, asset-light health companies are potentially powerful "disruptors" of existing business models.

These companies refrain from heavy facility investments and concentrate on effective care management. They operate without the high overhead costs of hospital-based providers. They deliver primary and specialty care services, manage care risk for large populations, provide Internet-based home care services and support shared decision-making. Notable examples of asset-light health companies include GroupHealth in metropolitan Seattle; HealthPartners in the Twin Cities; HealthCare Partners in El Segundo, CA; Dean Clinic in Madison, WI; and Kaiser Permanente in California.

While these organizations have existed for decades, they're now poised to exploit marketplace demands for more efficient and cost-effective care delivery through a number of distinct advantages:

- Asset-light health companies are not burdened by high overhead and facility costs. They use their facilities intensely and, when necessary, rent capacity at favorable prices.
- Asset-light business models align with patient/customer needs. They focus on prevention, provide appropriate care in multiple, convenient settings and avoid unnecessary hospital-based treatments. This enables asset-light health companies to deliver better care at lower costs, offer flexible treatment options for customers, support shared medical decision-making, and truly put patients first.
- Asset-light health companies are well-positioned for risk. They combine insurance capabilities with targeted treatment expertise, and their emphasis on earlier diagnosis, health promotion and appropriate medical intervention pays dividends where members pay fixed costs. The approach lends itself to direct contracting with employers that desire superior care management services, as well as bundled payment contracts and Medicare Advantage populations.
- Asset-light health companies can partner with traditional providers and payers on favorable terms.

Not surprisingly, asset-light health companies threaten industry incumbents. They are more efficient, customer-friendly and lower cost than traditional hospital providers with centralized, high-cost, treatment-centric business models. Moreover, asset-light companies are better positioned than payers for care management and population health. They can attract patient volume independently and limit payer responsibilities to third-party claims administration.

Most importantly, asset-light models, treat patients as customers rather than revenue sources by delivering patient-centric, value-based healthcare services.

DuPage Medical Group
WE CARE FOR YOU

THE DMG JUGGERNAUT

DMG currently employs more than 500 physicians in over 60 locations. The company provides primary, specialty and ancillary healthcare services to nearly 400,000 patients/customers. DMG generates annual revenues in excess of $600 million.

DMG formed in the early 1960s with an innovative physician group practice model that delivered centralized, personalized, leading-edge primary and specialty care along with related medical services. In the early 1990s, DMG merged into MedPartners, the nation's largest physician management company. After MedPartners' 1999 divestiture of its physician practice business, DMG combined with two other physician groups to operate as an independent entity in the metropolitan-Chicago market.

Most physician groups employ business models that distribute all profits to physician partners at year-end without any retained earnings. In contrast, DMG's efficient operating model enables it to compensate its physicians well, generate substantial retained earnings and fund targeted strategic investment in facilities and ancillary services. These investments generate incremental earnings for DMG's physician partners. Today, almost 50 percent of DMG's revenues is non-physician generated. This business model has fueled DMG's rapid growth.

DMG believes physician independence and physician managerial control are competitive advantages. Customers follow their physicians. Accordingly, the company separates business and clinical decision-making. Physicians occupy a majority of seats on the company's corporate board. DMG's growth-oriented culture fosters innovation in the follow ways:

- DMG operates facilities and diagnostic services that are more convenient, efficient and cost-effective. For example, its ambulatory center conducts over 20,000 annual surgeries, more than double the level of typical ambulatory centers. Efficiency dramatically lowers per-unit surgical costs and boosts profitability.
- DMG's Management Services Organization (MSO) has advanced administrative capabilities that enable the company to manage risks, optimize physician productivity and reduce overhead.
- DMG's BreakThrough Care Centers manage care for fragile Medicare patients. Co-ordinated teams consisting of primary care physicians, micro-specialists, extenders, pharmacists, social workers and health coaches tailor care plans to individual needs. Their goal is to improve customer well-being and eliminate unnecessary acute interventions. For example, BreakThrough hospitalists approve and guide emergency care at local hospitals.
- DMG has engaged with Blue Cross Blue Shield of Illinois to access member cost and quality data. DMG bolsters its care management capabilities through deeper understanding of patient risk stratification, outcome variation and facility costs. This helps DMG physicians deliver the right care at the right time in the right place.
- DMG assumes payment risk in all its contracts. It adjusts transaction structures to meet customer and market needs. DMG welcomes the opportunity to take full-capitated risk with Medicare Advantage patients. Many providers aspire to offer superior care management, but few achieve that goal. As DMG CEO Mike Kasper observes, "I've never met a provider who didn't think they can manage risk. Few ultimately can."

Kasper's growth strategy is to "monetize DMG's efficiency." He wants DMG to double operations in 3-5 years through internal growth, acquisition and expansion into new geographies. Requiring a strategic investor that could provide capital, advice and complementary professional services, DMG turned to Summit Partners.

SUMMIT PARTNERS

SAVVY SUMMIT

Summit Partners is a growth equity firm with a long-term partnership-oriented investment perspective. In the healthcare sector, they focus on growth-oriented health companies "skating to where the puck is going (value), not where it's been (volume)." They welcome minority-ownership in well-run companies. Summit is a minority investor in more than 70 percent of the companies in its healthcare portfolio.

Summit understands the potential embedded in physician-led care management companies. Managing Director Darren Black describes Summit's healthcare investment philosophy this way, "We help physician groups that want a growth partner. We work side-by-side with them to build value right out of the gate and over the long-run." Summit's positive experience as investors in HealthCare Partners has encouraged the firm to explore similar physician group investment opportunities. In DMG, Summit identified a rare combination of advanced care management and practice management capabilities.

Based on their work with HealthCare Partners, Summit believes physician groups are best positioned to manage care within integrated delivery networks. Such companies keep their patients healthy through pro-active, prevention-focused care delivery. Engaged care teams working in concert with informed, engaged patients produce superior outcomes at lower costs. As Darren Black observes, "Historically, care is delivered at the most expensive place possible. We want to change that idea and make sure care is delivered efficiently with better outcomes."

Everybody wins.

Summit Partners provides far more than a "monetization opportunity" for DMG's physician shareholders. Summit will help DMG identify and evaluate growth opportunities in new markets. DMG will rely on Summit to value potential acquisitions and conduct due diligence. Summit also will provide ongoing perspective on risk management, capital formation and market evolution.

The best strategic partnerships align interests, respect partner expertise and pursue agreed-upon objectives together. Never under-estimate the potential of strategic collaboration in pursuit of superior performance.

POWERFUL MEDICINE

Many physician groups confront a strategic quandary. They lack the capital, market positioning and organizational capabilities required to compete in value-based care delivery. As a consequence, many have sold to health systems, but remain unsatisfied. Other physician groups resist consolidation. They believe physicians are best-positioned to manage patient care. These physician groups will find like-minded partners in asset-light companies like DMG and strategic investors like Summit.

The combination of high-performing physician groups with savvy private equity investors has enormous potential to disrupt entrenched and inefficient healthcare business models. Disciplined growth capital enables integrated physician groups to expand value-based service provision to new markets. As risk-based payment expands, expect asset-light health companies to gain market share.

The rise of asset-light health companies is good for consumers, employers and the American economy. Better health outcomes for less money will redirect resources into productive investment, more take-home pay for regular workers and healthier communities. Let's toast to their continued success.

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Carsten Beith joined Cain Brothers in 1993 to open the firm's Chicago office. Mr. Beith is the Head of Cain Brothers' Health Systems Group and a member of the Firm's Executive committee. With over 22 years' experience, his engagements have encompassed a broad range of transactions covering hospitals and health systems, academic medical centers, physician groups, managed care organizations, and other health care service providers. Cain Brothers is a pre-eminent investment bank focused exclusively on healthcare. Our deep knowledge of the industry enables us to provide unique perspectives to our clients and is matched with the knowhow needed to efficiently execute the most complex transactions of all sizes. | **www.cainbrothers.com**

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David Johnson is the CEO of 4sight Health, a boutique healthcare advisory firm. Dave wakes up every morning trying to fix America's broken healthcare system. He is a frequent writer and speaker on market-driven healthcare reform. His expertise encompasses health policy, academic medicine, economics, statistics, behavioral finance, disruptive innovation, organizational change and complexity theory. Dave's forthcoming book, Market vs. Medicine: America's Epic Fight for Better, Affordable Healthcare, will publishes shortly.