Health-Care Reform: Novice GPs Need Not Apply

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Health-care reform will open up opportunities for buyout and venture firms. But investors won't be trusting just anybody with their capital.

The legislation passed by the U.S. Congress will help over 30 million people gain health insurance coverage, bringing new ways for making money to firms investing in health care. But it will also cause upheaval in an already difficult-to-navigate sector.

In one example, general partners worry Congress could try to control health costs with measures that squeeze companies' margins. They look at the creation of the new Independent Payment Advisory Board, which will recommend ways to curb excess growth in health-care costs, as having the potential to make new therapies tougher to get reimbursed, for instance. In another example, they are cautious about an excise tax on medical-device sales that thus far applies to small as well as large companies, potentially cutting into the profits for venture-backed businesses disproportionately.

Issues like these mean investors are likely to favor the most established and knowledgeable general partners with their capital as the private equity community works through the implications of reform along with everyone else. "The more experienced funds are going to be favored even more in this environment," said Richard J. Zall, chair of the health-care department of law firm Proskauer Rose LLP.

The law is unlikely to spur institutions to invest any more in the field than they did previously, given that health care was already a giant industry. But it could affect where they place their bets. The new money promises to boost existing markets and foster new ones. Expanding insurance coverage should increase demand for primary-care treatment and benefit sellers of products used in doctors' offices and emergency rooms, for example. Meanwhile, companies making health services more accessible and less expensive by offering them outside of hospitals also stand to profit as demand for medical care rises.

Various aspects of the law help different kinds of investors. Venture capitalists, for instance, applaud the 12 years of data exclusivity granted to new biological drugs, giving biotech start-ups time to profit from their products before "biosimilar" drug-makers can attempt to copy them. They also like a tax credit for certain therapeutic research and development expenses, as well as the Cures Acceleration Network, which could boost disease research through grants.

For private equity firms, health-care sectors that have long been their stomping grounds like health plans and smaller specialty hospitals may see margins pressured due to proposed but as yet undefined reimbursement cuts. But firms see opportunity here too, perhaps for consolidation. "No matter how you slice it, there will be an opportunity to do roll-ups," said John Callahan, a partner with McDermott Will &

Emery.

Meanwhile, private- and growth-equity firms are eyeing the opportunity to bankroll companies with strategies to make the delivery of health care more cost-effective. There is also likely to be increased interest in using health care-information technologies to make medical centers more efficient and to help patients make informed decisions, according to Barbara Piette, managing principal of Knightsbridge Advisers. "Health care-IT ultimately will go a long way to let us make choices we need to make as consumers," she said.

Even so, institutions will favor firms with a track record of investing at the intersection of health care and IT, not technology investors who are just now trying to catch the wave. "I would think we'll see some prevalence of that, but we would be skeptical of firms doing health care-IT now that haven't done it historically," said Robert Mazzoni, an associate with TrueBridge Capital Partners. "We'll partner with some firms that are experienced in that space."

-With Rimin Dutt