Considerations in the Current Landscape

1. **Major health service providers—both health plan systems and hospital systems—are developing incubators.** These business development arms function exclusively for the sake of the health service providers, making both minority and control investments in start-up and early-stage companies. If the venture—be it a pilot research program or a new medical device—fails then it’s only a minor financial loss. However, if it succeeds, the health service provider already has access to proprietary information, knows the management team well, and has the inside track to acquire the startup before it goes to market and is sold to a competitor. This incubator strategy has become more noticeable in recent years and we envision more of these in-house venture and private equity units will appear in 2015. Quickly wising up to their impact, startups have added them to their must-call list when searching for investments.

2. **Consolidation and integration serve as inroads to increased profits and lower barrier to entry into the health care industry for private equity firms.** Health care service providers outside of hospitals—such as occupational and physical therapy centers, imaging centers, and dental practices—remain fragmented fields. With less regulation and lower operating costs than medical facilities, they continue to be good targets for consolidation and aggregation. Further, non-medical services for both doctors and patients—such as billing, reimbursement, practice management and care consulting—are also attractive investment opportunities for private equity sponsors.

3. **Analyze cyber risks and rewards in the mobile health revolution.** Startups are developing mobile health care solutions at a fast pace and actively seeking investments. Massive corporate hacking attacks have taught us that data security is not only fragile, but that breaches can be massively harmful, both financially and to the target’s reputation. In addition, patient privacy is a particularly risky area in health care investing. Sponsors should consider robust data security diligence of the technology before making an investment. Health care startups that can demonstrate strong cyber and data security will be more attractive to sponsors than those that have paid it short shrift. We also expect to see technology providers and consultants that can deliver sophisticated data security platforms and analyses, both for mobile health care companies and their investors, having a very busy year in 2015, and themselves becoming attractive targets for investment.

4. **The traditional exit window is a five-to-seven-year timeframe. However, in recent years, that window seems to have widened to a three-to-nine-year exit horizon.** We believe the causes include, on one hand, more fund-to-fund deals early in an investment’s life cycle coupled with historically low interest rates; on the other hand, serious dislocations in M&A markets that are only now healing, and an IPO market that has never fully recovered from the 2001 correction. As fund investors get more comfortable with longer time horizons, we expect that this will become the “new normal” for PE funds in health care and other industries.
Upcoming Katten Webinars and Panel Discussions

- Ethical Considerations in Health Care Transactions
- Investing in Ancillary Services
- Deal Financing: Current Market Conditions
- “The Five Things I Wish I Had Done Before I Started the Auction”
- Reimbursement and Deal Structures, Value-Based Compensation
- Connecting Not-for-Profit Health Care Businesses to For-Profit Entities

If you are interested in participating in any of these events, check our website for dates and registration details as they are made available at www.kattenlaw.com/events.

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