The Top 5 Stocks that Will Weather the Coronavirus Storm

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HOW CAN PRIVATE EQUITY RECAPTURE LOST PROFITS

Craig Lack - Catilize Health

RECAPTURE LOST PROFITS & TRADE FOR ENTERPRISE VALUE GROWTH

Craig Lack, President of Catilize Health, explores adding a new objective to a private equity firm's investment thesis.

About Craig Lack

Craig Lack advises financial executives on increasing Enterprise Value. He consults public and private companies, PE Firms and independent consultants on how to transfer risk. He speaks at national conferences, business coalitions on health and to C-Suite groups. Craig has appeared in Forbes, Inc., CEO Today, Yahoo Finance, Success, Fast Company, and featured on CBS, ABC, CW and FOX.

CATILIZE HEALTH

www.catilizehealth.com

The first 100 days for a private equity (PE) firm is typically the culmination of an intense planning process. A PE firm – if it has chosen its acquisition wisely – has a five-to-seven-year plan where new metrics are emphasized, synergy savings are prioritized, and operational improvements begin to materialize.

PE firm business acumen often identifies suboptimal operations, limited market channels, misallocated capital and stymied growth opportunities. The investment thesis of PE firms touches on all the standard objectives.

So where is the unrecognized blind spot in the first 100-day strategic plan?

PE firms have the market power to influence and reduce healthcare costs at portfolio companies, however, the vast majority of firms haven't exercised this power. Generally speaking, PE firms and businesses have abdicated accountability to insurers, government and healthcare supply chain providers. This has resulted in a never-ending upward pricing increase at four times the rate of inflation. Essentially, portfolio companies have been the financiers of the inflated stock returns of healthcare industry providers like PBMs, hospitals, surgery centres and medical device companies.

The net impact of unmanaged healthcare is the largest personal and corporate confiscatory tax of the last 20 years in America.

Lack says he likes to ask, "What's the smallest action you can take to lower the healthcare budget?"

1. Are you applying the same strategic rigor to your portfolio healthcare strategy as you do the rest of the business?

2. Is the healthcare investment a stated PE or C-Suite priority?

3. Can the recommended healthcare strategy control costs measurably and repeatedly lower the frequency and severity of claims?

Lack explains, the financial engineering of healthcare risk to reduce cost and improve the portfolio balance sheet sounds about as exciting as driveway gravel, but once the PE firm can see the economics it gets very interesting very quickly.

He continues: "As good as this is for our clients, including the largest privately held insurance agency in America and the fifth-largest sports brand in the world, it's even better for private equity portfolios." He walks the reader through his thinking.

"How are other organizations able to spin off risk and avoid the inevitable adverse risk creep?

"Too often healthcare managers at portfolio companies are unable to quell the uncontrollable upward spiral of claims cost. Consequently, process and administration become the proxy for quality healthcare, and managers become trapped in a quest to find the next Best Practise, but they inevitably create less and less value.

"But what if a PE firm could stop trading lost profits, spent negligently on healthcare claims, for enterprise value growth?"

Last year Lack notes that a PE-owned client increased enterprise value growth by transferring risk in a way that no incumbents or vendors were replaced, no disruption or administrative burden was created, and there was zero employee noise.

On the contrary, participants love their experience, and HR supports expanding the engagement. More importantly, Catilize Health, through its SIHRA program, measurably and predictably increased the annually recurring revenue and EBITDA of its client, which improved enterprise value.

TODAY'S NEWS

Healthcare is a constantly changing environment – the technology, the cost of treatment, the reimbursement rules and government regulations. That's what makes it so complex.

We all know this. The most common trends are easy to recognize – they're on the front page every day:

- The cost of medical care is increasing every year.
- The healthcare budget is now typically the second-largest operating expense ahead of IT spending. PE firms see this in their portfolio companies.
- And now, healthcare is the second-largest expense for employees and their families behind only their mortgage or rent expense.

"We all know the cost of healthcare is going to continue to be painful for companies and families. Because of our experience managing hundreds of thousands of claims for tens of thousands of employees, we have developed unique insights," says Lack. These include:

1. To reduce healthcare costs, you actually have to increase benefits. It's not linear as many think: i.e., reducing benefits translates into reducing costs. The reality is there's an inverse relationship between cost and benefits. Most executives are shocked to look behind the curtain and see that quality and cost are inversely related.

2. 1% of employees incur 25% of ALL claims – and there's a name for them. They are called Super Utilizers and are the cornerstone of our risk management solution.

If you can do something about your Super Utilizers then you can:

- Completely change the economics of the healthcare budgets in your portfolio.
- Arbitrage the cost of health claims by double digits (spinning off the Super Utilizer risk). A typical self-funded company books an unfunded liability of $100K-$1M per member and SIHRA lowers that risk to less than $5K.

WHY IT'S HARD

There are obviously many options available with healthcare consultants and brokers.

But it's hard to really know if you're exploiting all the opportunities available because the industry sets up so many roadblocks.

- The healthcare supply chain dictates terms to companies. No one knows the cost of anything until they get a bill 30 days later!
- The insurance companies prefer to sell a black box, hide their margins and they aren't transparent. They're set up to look like a bond but in some years receive stock-type returns on your premiums. Most companies manage healthcare like a gambling addict – they might accidentally win once in a while, but they fully expect to lose every year!
- Industry Best Practises have mostly failed to produce measurable savings for years.

Additionally, one has to include the roadblocks established by the companies themselves:

- The culture of many companies rewards status quo and creates a fear of change.
- Innovation is perceived as risky so the path of least resistance is the rule.
- While operational improvements are routinely implemented – healthcare is ignored.

THE SOLUTION

Catilize Health's SIHRA technology transforms uncertain large liabilities into small fixed expenses by driving employee engagement into a medical plan that arbitrages pricing asymmetries. As a result, participants receive 100% coverage, claim liabilities are capped, and enterprise value grows substantially.

SIHRA is bolted next to your existing health plans without the need for changing any vendors, consultants or health plans. It enables companies to pivot healthcare from an operating expense into an asset that generates free cash flow and earnings.

Lack paints a typical picture to better visualize SIHRA:

- An average self-funded 5,000-employee company will spend $60M on its healthcare.
- The company will purchase stop-loss reinsurance protection of about $700K per member This means the company has an unfunded maximum liability of $700K for every member (for example, 5,000 employees = 10K+ members).
- The SIHRA solution shows the company how to arbitrage that risk from $700K per member down to <$5K per member.
- A family of four translates to $2.8M in unfunded liability and the SIHRA reduces the unfunded liability to <$20K for the family.

HOW SIHRA WORKS

The SIHRA works by leveraging behavioral economics. Science has proven that human beings are risk-averse and will act in their own financial self-interest.

Free cash flow is created by attracting a disproportionate number of high claimants (the Super Utilizers) to enroll (spin-out) in alternate group coverage by offering them 100% medical coverage with zero out-of-pocket expenses. They voluntarily elect coverage.

When employees save thousands of dollars in out-of-pocket expenses after enrolling in the SIHRA, they let all their coworkers know of their savings. Consequently, enrollment grows organically every year, which produces larger savings and higher enterprise value.

It works because each of the portfolio company's medical claims is dispersed in the same way:

- 1% of members incur 25% of ALL Claims
- 5% incur 50%
- 20% incur 80%
- 30% incur 93%

As a result, the most ill employees and their families will jump at the chance to avoid losing thousands of dollars in out-of-pocket expenses that they currently spend – because they are Super Utilizers!

They avoid losing money by enrolling in alternate group health plans, which could include a participant with a second job, parent's coverage or spouse's group medical plans.

When employees and their families receive richer benefits by enrolling in 100% medical coverage, claims are eliminated, cash flow is generated and the balance sheet improves.

VALUE PROPOSITION

The SIHRA is accretive to earnings, which gives you tremendous ROIC.

- Results are cash flow positive in the first 30 days, with measurable, predictable and certain results produced.
- Our compensation is 100% performance-based.
- We earn a gain share of 30%.
- Multiple billion-dollar stop-loss carriers offer premium discounts.

Maybe even more importantly, the PE firm reduces its risk. PE firms that utilize first-mover advantage with SIHRA will be able to see unrecognized risk and liberate trapped capital from overfunded defined-benefit health and welfare plans. For PE firm clients, suboptimal risk management and financial infidelity caused by taking on too much adverse selection can be improved and reformed. Healthcare can be a competitive advantage that can act as a handcuff for talent retention and a magnet for recruiting.

Before you purchase a company, picture being able to see around all corners.

You could know in advance how much exploitable liability is currently trapped inside the target company's healthcare budget.

Lack says: *"I can't imagine that wouldn't be on everyone's to-do list."*

The indirect benefits that Catilize Health delivers in part impacts everything that matters in a company, whether it's human capital-directed or financial results-focused.

How often is a PE firm reviewing a profit opportunity that is tested and proven with financial results that are irrefutable? Replicating the same performance and outcomes is only incumbent upon taking action. The blueprint is defined, and the full potential can be modelled.

By harnessing the Catilize Health SIHRA technology, healthcare can be transformed from "a tapeworm on corporate America" as Warren Buffett stated, into a competitive advantage that is accretive to the bottom line and increases enterprise value. All that is left for PE firms to ask is why they haven't applied the disciplined SIHRA strategy as a profit lever because the status quo is a perennial loser of profits and enterprise value.

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CATILIZE HEALTH SIHRA PROGRAM AT WORK

Last year, a health insurance company implemented the Catilize Health SIHRA program and offered it to its workforce. After experiencing the program's positive fiscal impact, it has now created a retail health plan that includes a multi-year rate guarantee when the SIHRA is designed and communicated per specifications.

In addition, many of the largest publicly traded, privately held and PE-owned insurance agencies are contracted with Catilize Health. The largest privately-held insurance agency in the United States utilizes the SIHRA program for its 11,000-plus employees, and its private-equity-backed owners are experiencing a higher ROIC, lower costs and higher enterprise value.

Now, the question is whether a PE firm's investment thesis can afford to be laissez-faire with passively "managed" healthcare at their portfolio companies knowing that there are tens and hundreds of millions of dollars of unrealized enterprise value trapped as stranded costs.