

# Nashville Medical News

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## Optimism Reigns Among Lenders and Investors

Budding flowers and warming temperatures aren't the only signs of optimism as winter prepares to give way to spring and the business year of 2005 gets into full swing.

The healthcare financial markets are matching that optimism this winter with an outlook that approaches near giddiness.

Whether the focus is on the overall economic outlook, the general equity and debt market outlooks, or the specific outlook for healthcare finance, virtually every signal is on Go and both lenders and equity investors are projecting their most active year so far in this decade.



*Turney  
Stevens*

### Healthcare Lending

This is a good environment for borrowers, despite the increased activity level, because availability is up and pricing is falling due to increased competition and aggressiveness among lenders.

GE Healthcare Financial Services, in a recent presentation to our bankers at Harpeth Capital, pointed out that they view healthcare as once again being a safe defensive play for most lending institutions, theirs included. They project that access to capital for nearly all healthcare sectors is increasing.

In specific sectors, optimism is high across the board. Much of this has to do with the generally accepted outlook that both Medicaid and Medicare rates have neutral outlooks for the next twelve months.

The assisted living sector is finally showing signs of real life with increased occupancies, higher revenues, and minimal speculative development. Skilled nursing is also improving with stable occupancies and positive reimbursement trends.

Medical services and medical instruments are driving the use of capital with 36.8

percent and 28.2 percent of total loan dollars respectively in the first half of 2004 consumed by these two sectors. Hospitals (19.9 percent), pharma (12.1 percent) and post-acute care (3.0 percent) trailed.

The primary purposes for these loans were: refinancings (31.7 percent), leveraged buy-outs (26.4 percent), and acquisitions (24.5 percent).

Pricing trends are favorable for borrowers, with leveraged loan prices according to Standard and Poor's, moving down from a cyclical high of Libor plus 388 basis points in 2000 to an average in the first half of 2004 of Libor plus 272 basis points. That's a decline of more than a full percentage point in note rate as the cycle reached its low point and conditions improved with competition heating up.

### Private Equity

The National Venture Capital Association (NVCA) predicted in its 2004 year-end assessment and beginning of the year forecast that 2005 will see a strong competitive environment among VCs with the beginning of the new business cycle.

Interestingly, NVCA is forecasting a return to early stage investing by VCs as new funds are raised and those dollars employed without the exit pressures felt by fund managers who are further into their funds' life cycles.

Tracy Lefteroff, global managing partner of the venture capital practice of PricewaterhouseCoopers says, "Good ideas will not be good enough as competition for funding remains fierce. Gone are the days when ethereal ideas got seed money, just to flesh them out. In 2005, even start-up companies had better have some meat on their bones if they are to attract venture capital."

Our private equity practice here reflects this outlook as we work with fund managers across the nation. The proven model for early stage ventures is a highly experienced CEO, acquisition targets in the pipeline so that a platform can be created with initial funding very quickly, and the prospects for future growth coming rapidly from both

improvement in operations and additional external growth. Good ideas alone will continue to be almost impossible to fund, at least with institutional equity.

As a practical matter, we believe the sweet spot will continue to trend upwards however. This is a result of fund managers raising ever-larger funds and facing the practical problem of how best to oversee the funding for each portfolio investment. If you raise \$200 million and you or an associate have to serve on each Board of each portfolio company, you quickly conclude you have only so much time and therefore have to make larger investments per deal as a practical matter. In the past five years, we have seen this so-called "sweet spot" move from, say, \$3-5 million of investment per deal to the high single digits and low double digits.

Another trend we continue to see among fund managers is the increasing employment of "deal finders." Rather than sit back and wait on management or bankers to bring them deals, these business development officers are traveling the countryside calling on companies and bankers in an effort to learn about deals before their fund competitors. We are happy to receive them but still conduct a carefully orchestrated competition for each deal in order to maximize pre-money valuation for each client. The important thing, though, is what this new-found deal appetite says about the amount of liquidity out there that must be put to work in new deals.

The year promises to be a good one for all concerned. As these seasons of life come and go for me, I become more convinced than ever that the windows of opportunity open infrequently and only briefly. We believe the window will be open in 2005.

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