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Interview with Ben Magnano, Managing Partner of Frazier Healthcare Partners; Dan Agroskin, Managing Director and Management Committee Member of JLL Partners; and Tony Davis, President and Managing Partner of Linden Capital Partners

Interview Conducted by John Soden

Below is an edited transcript of the April 8, 2020 interview.

This is John Soden, Managing Director at Cain Brothers. I'm pleased to be here today with a panel of very well-known healthcare private equity investors. Ben Magnano, Managing Partner at Frazier Healthcare Partners; Dan Agroskin, Managing Director and Management Committee Member at JLL Partners; and Tony Davis, President and Managing Partner at Linden Capital Partners.

John Soden: ***We were blindsided by this crisis like everyone else. Are there any early learnings that have come out of the initial stages including what preparations you've made intentionally or otherwise that have paid off?***

Ben Magnano: I won't claim anything intentional. As you aptly said, we were all blindsided here. That said, Seattle was on the early side in the United States, so I think for better or for worse, Frazier Healthcare Partners (Frazier) had a two to three-week head start on most of the rest of the country.

Frazier immediately flipped tactically. Our entire office worked remotely from home in the first week of March. We simultaneously had closed our schools and saw the city shut down quickly. That was an easy tactical decision.

Frazier’s new reality immediately started out with daily calls with our entire investment team and all our operating resources around the country.

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The first thing we did was take our entire portfolio through an exhaustive stress test. It took us a week and a half, two weeks to execute on this in partnership with the management teams. Part and parcel with that included jarring down all available liquidity across the portfolio, going through the line-by-line expense management work with our CFOs, working capital optimization and the like.

The other piece we pushed on with our operating resources was standing up a vertical leader or functional area so we could help the companies. And those included things like supply chain, human capital, navigating potential furloughs, rifts and things to come. Somebody needed to see over debt capital markets and assist our CFOs there. We had a medical and healthcare vertical staying informed on the spread of COVID-19. One of my partners is a medical doctor and an academic researcher by training, so he was on point for that.

After we got through those harried first couple of weeks, we've slowed down our cadence to Monday, Wednesday, Friday calls. We switched everything over to video to keep as much of a human element as we could to our jobs, especially for the junior team and those that don't have families and kids pressing all over them all day. Being able to look at people and interact both with the portfolio companies and with our investment team was important for us.

Dan Agroskin: The only thing to add, and it's a little bit of a copycat of what Ben said, but when I think about the constituents who are in our ecosystem, it's all the employees of JLL Partners (JLL), we shut down the office early on. In fact, we had to kick some of our associates out of the office. JLL mandated working from home and leveraged a virtual model as well.

It was relatively straight-forward. I wish I could say that we had some advanced pre-work of how we're going to work remotely. We didn't. Fortunately, with the IT improvements and inventions over the past few years, it became seamless. Everybody is well organized. We're doing Zoom calls across the whole firm once a week. We're including everybody, not just the investment professionals. Twice a week we have just investment professionals on. The office is operating at a good pace and everybody is getting done what they need to get done.

We've then focused on the LPs and have improved the communication around that and made sure we were transparent around everything. And I know we will talk about LP communication piece.

Much like Ben described at Frazier, the goal for our portfolio companies was to troubleshoot and get through crisis management situations that were severely impacted. We had to ensure ample flexibility and runway from a liquidity standpoint. For other businesses you have a scenario plan if things get worse but at the current run rate they're not really impacted as of today. Doing that pre-work was critical, and we continue to stay on top of those things.

John Soden: How did you address scenario planning and liquidity concerns with your portfolio companies?

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Tony Davis: Linden was at the very front end of drawing down our revolvers across the entire portfolio. Early on Linden started its scenario-based planning and talked about ways to create a liquidity - running 13, 26-week and end-of-year-cash flows in every way imaginable from cutting or deferring salaries of senior management, laying off or furloughing people if appropriate, depending on the severity of the financial health of the company. It's all very much based on each specific company. We looked at every expense within the company that we could cut, delayed payables, accelerated receivables or offered slight discounts to pay the receivables early, which actually worked. We've evaluated all our options to ensure that Linden's portfolio companies are in a [strong] liquidity position coming out the other side of it.

Ben Magnano: Frazier has taken a very similar approach. The back end of our liquidity analyses very much mirrors Linden's, and Frazier has conducted a double and triple check on the reserves that we have against each of our portfolio companies. As we looked at 13, 26-week and end-of-year cases, we needed to revise or reserve more capital in individual circumstances after going through all the exercises that we've all discussed. In some cases, we've got LP or other GP co-investors. We're making sure that we're all joining hands and synced up on the approach that we were going to be taking depending on which scenario we were signing off on.

John Soden: ***How have the lenders reacted? Have they been constructive? How have those initial discussions gone?***

Tony Davis: It varies by lender. Some lenders are healthier than others, and some of the relationship lenders have remained relationship lenders. I think others have more difficult portfolios and have become somewhat less relationship-oriented than I would have expected. Generally, if lenders believe a company has been well managed and the private equity firm has worked very quickly to cut costs, work through various scenarios and liquidity ramps, and is willing to support the company from the fund itself, then lenders are being fairly amenable. If they don't see that, some lenders are getting more aggressive than I would have anticipated.

Dan Agroskin: It's early because the big date that came and went was March 31st, when the first quarter interest payment was due. Even the businesses that were most severely impacted made those payments for the most part. As for the next big date, decisions will have to be made, and they're not going to be easy, whether those payments are made for businesses that are effectively shut down. That's when you will see how the interaction between the private equity firm and the lenders are going to be.

My sense is that lenders will be a little bit more flexible and understanding because this is not a typical workout situation for challenged businesses. That being said, lenders have their own constraints and imperatives and they also potentially have back- leverage that they must deal with. I'm sure lenders will operate in their best interests, although maybe there's going to be a little bit more flexibility. I do think that there's going to be tough situations to come if the crisis continues for more than a month or two.

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Ben Magnano: At Frazier we have had plenty of top-of-the-house to top-of-the-house conversations with folks where it started right out of the gate with 'open for business, let's engage, let's figure out ways to work through this together.' And in some instances, tenors changed rather quickly, like within a week. I think they were starting to get a better understanding of what was going on in their own portfolios.

So, to Dan's point, 3/31 was key and I think if there was a constructive approach there, then they were willing to say let's all figure out where we are at end of 2Q, end of 3Q.

John Soden: ***What sectors within your portfolio have been impacted to date, and what of portfolio companies are going to emerge stronger and why?***

Dan Agroskin: The irony of this crisis is that in some ways, the businesses that are most defensive are the ones on the front lines of being hit. For example, anything related to retail healthcare and physician-centric businesses that are effectively shut down, dental practices, physical therapy, dermatology and other physician-partnered businesses. They are probably the hardest and the fastest hit and may be the slowest ones to come back. Even when life goes back to normal, dental procedures are not going to ramp back to a hundred percent overnight and there is going to be a long lead time for those businesses to return to normal levels.

The challenge will be that you can forecast when a business re-opens, but they may be operating at suboptimal capacity utilization – maybe 70-80 percent. None of these businesses are equipped to make money at those levels. Getting through that ramp-up period will be challenging for some of these businesses.

The other area we've seen hit, tangentially related, is elective procedures. Those are obviously delayed, either because the hospitals don't have capacity, because of the directive from the regulators, the patients or the doctors are just unwilling to perform them. That's the other big area that has been hit.

Ben Magnano: Similar sentiment for provider businesses are most heavily impacted, and in some instances, volume is down more than 70 percent in certain geographies. The interesting part is that on the flip side, some of those businesses are in the best position from a liquidity standpoint because of the way they're structured. They're productivity-based and their largest variable expense is provider compensation.

No one is excited about lowering expenses because we're not paying for production. But it's a good balance with respect to stress testing these businesses and thinking about how long they can last with the decreased volumes.

One bright spot to highlight is Matrix Medical, a network of nurse practitioners that normally service MA plans and helps them conduct health assessments and risk adjust their populations. Matrix has had opportunities, which we

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certainly didn't see coming, including participating in Vice President Pence's task force around how to proliferate testing more broadly in the country.

The second one was a way for Fortune 50 companies to provide clinical services onsite. That's become a ‘keeping businesses up and running, risk mitigation’ and employee-based PR move for a couple of Fortune 50s that have signed agreements with Matrix just in the last week or two, which we probably wouldn't have been talking about if not for the pandemic.

John Soden: ***Are there other fringe benefits associated with unique efforts that are being exerted within the companies and at the management level? Are these companies going to come out stronger or is it just purely an effort to get back to the normal level of operation?***

Dan Agroskin: The optimist in me would say yes. Stress testing businesses will ultimately make them efficient and drive better delivery of their services. Maybe on the margins, but I'm not sure I would have wished this for companies to go through because the stress that they're incurring, both for the people on the ground and the management teams, is pretty dramatic and it will weigh on the overall strength of the businesses for a while, even after the crisis subsides from today’s levels. I'm more optimistic on that front.

Tony Davis: I generally agree. As a general matter, that's true. There's going to be long-lasting impacts. To the extent that there is any silver lining, Linden has a few businesses that are dramatically ramping up their digital delivery of healthcare services.

John Soden: ***Given that the risk profile of the portfolio is not what it was expected to be given the unusual nature of this crisis and the speed at which we've been hit by this crisis, how do you go about communicating with your LPs?***

Tony Davis: Linden has taken a forthright and aggressive approach with our limited partners. Very early relative to how this unfolded, we had a call with our joint advisory boards across all three active funds and laid out a bearish view on how we thought it would impact the US economy, and then specifically went through the funds. We received feedback that that it was the most negative call that they had at that point. Within a week or two, they felt that we were spot- on and they appreciated how forthright we had been.

We followed up with another advisory board call and, for the first time in our history. We had an all-investor call for literally every single investor in the fund and addressed fund-by-fund where we thought things were headed. We also discussed where our companies were by tier - red, yellow, or green - as many people have done, both from a revenue and liquidity perspective.

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Linden also let its LPs (or investors) know that for Fund IV, it's nearly 60% uninvested and as a result we've got a lot of dry powder there and there should be some great opportunities going forward. While our Funds II and III will be negatively impacted from this, the reality is our Fund IV will probably end up being a better fund because of the buying opportunities.

We've tried to let investors (or LPs) know about capital calls. We're trying very hard not to issue capital calls right now, understanding that people are not in a particularly liquid position. We then talked with our advisory boards about what they want us to do, so we've also spent a lot of time talking about how we're defending those companies that are in the red zone, and the yellow zone is fine for now. If this goes on a long time it could be different, so Linden has opted for more frequent and more open communication.

Dan Agroskin: JLL took a very similar approach to Linden. We have been very transparent with our LPs, and over-communicated both the good and the bad. We also put out a couple of detailed memos describing what we have seen on the ground early on for each company. That information changes rapidly so we continue to stay abreast of our communications to provide real time updates. I agree that the silver lining here is for uninvested capital. There should be great investment opportunities and I think the investors are excited about that. But they are much more concerned about what's on the ground already. I think over-communicating has been the best approach.

John Soden: How do you turn lemons into lemonade in this environment? Are there LPs that are willing to be supportive of doubling down given how attractive the evaluations are right now?

Tony Davis: At Linden, we have not seen investors willing to double down. I think they are trying to understand what the underlying liquidity needs are for the general partner. We're raising money for a different vehicle right now and there are people who are still interested in put putting money in that vehicle. LPs are not all shut down, but we haven't had any coming at us with aggressive requests around doing a special situation fund.

Ben Magnano: It feels like we're four to eight weeks out, to venture a guess, before people are really wanting to sharpen a pencil and think about those things. Based on my conversations with our LPs, they want to understand what marks may look like for 3/31 and then for 6/30 to the extent we're willing to hazard a guess. Investors are looking at their dials to figure out where that said spend from an allocation standpoint is first, before they start to be forward looking or opportunistic around new investment opportunities.

John Soden: Are you looking for a new platform deals right now or are you focusing on add-ons for your existing funds?

Tony Davis: Linden is not looking for any new platforms. We've been attending to the portfolio for the past month and we are principally focused there. There are some add-ons coming up, but it's going to take some time for sellers to adjust their price expectations for new platforms. And they're going to have to be in a distressed situation where they don't have much of a choice, so we are not seeing a lot of traditional new deal activity right now.

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Dan Agroskin: JLL is seeking new platform deals. We are defending the companies that we own and ensuring that they are progressing in the right direction. On the new deal front, we will be opportunistic. During the financial crisis of 2008, we made several investments that proved to be quite successful. We're going to look at the secondary [debt] market to the extent that the yield approaches equity-like returns. We haven't seen a lot of companies at those levels yet. For the companies that are trading north of 20% yield to worst, or those that had issues going into the downturn, this will probably tip them over.

You're taking principal risk, and businesses that had issues around the crisis have not come down in price yet, but that's going to be something that we're going to look at closely. Along the same vein, if we can be an investor who can provide a PIPE or some kind of structured equity to a public company to either deliver or give them capital to be aggressive or other liquidity solutions, as long as it's priced at equity-like returns, those kinds of structured type of investments are ones that we're going to take a hard look at. Whether or not its actionable will be determined by how long the downturn continues and how long the economy stays shut down.

John Soden: On the debt side for your existing portfolio companies, some of the debt may be available at very attractive yields. Is that something you actively look at?

Dan Agroskin: JLL has the ability to acquire debt in our portfolio companies. The yields are not really where it would make any sense for us to act on it yet, but if there's a way to capture equity value we would certainly consider it.

John Soden: Where would you do that investment? Do you back lever that at the GP level or does to go into the same vehicle that's already invested in the equity?

Dan Agroskin: No, you'd have to do it in the same fund. Doing it from different funds would cause serious conflicts. We would approach it by talking to the advisory committee to ensure that everybody's onboard. As long as there's comfort around buying the debt in our companies, it could be a very attractive way to enhance equity returns. But you must do it in conjunction with the advisory board.

John Soden: As you look at the waterfront of opportunities and what we assume will exist in the next month or three to four months from now, what will be the most desirable sub- sectors to invest in? What will recover the fastest, and what is likely to be somewhat predictable in the interim period? Have you started to do that landscaping effort?

Ben Magnano: I think the most obvious answer is with either facility-based or provider-based elective procedures where you've had long waiting list and plenty of demand and it probably takes the bravest souls to lean in on something like that without knowing how long this pandemic will persist. Some of those areas are places where Frazier is spending some time. As previously mentioned, the advent of technology being pervasive in a wide range of practice-based businesses is an area that we all look at, and it's here to stay. For Frazier, looking at healthcare IT specifically and around tools and services provided to payers, and broadly the healthcare payments space could be opportunistic as we venture forward.

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John Soden: ***Given that you have a unique purview over the health care segment and its sub-segments, which ones are likely to be the most exciting to invest in?***

Dan Agroskin: JLL will look for opportunities in the sectors that have been most impacted by this downturn to get in at a semi-distressed level or interesting entry point as a way to play the other side of the crisis. Most of these businesses have good, healthy business models that should come back in time. So, one area of focus for us is those which are most impacted, as well as thinking about areas that may be have benefited by the crisis. We've talked a little bit about telehealth and digital delivery of care, diagnostics, personal protective equipment areas. Those businesses have really been on the upside of the crisis, if there's such a thing.

Healthy segments such as healthcare IT and payment-type businesses have historically traded at a sky-high multiple and have come down and are good areas to invest in. If you look across the different sub-sectors of healthcare, the enterprise value to EBITDA dies down four to five turns. I'm not sitting here pretending the seller's expectations suddenly have gotten to those levels. But certainly, there should be better buy-in valuations for really attractive businesses that have traded at that sky-high multiples just a month ago. And take advantage of maybe people pulling in risk and valuations coming down.

John Soden: ***As you look in your crystal ball, what's your best case for return to a normal environment?***

Tony Davis: It really depends on which business we're talking about. There's been a lot of discussion around multi-site healthcare businesses and how long they will take to normalize. Linden was very early in calling for an extended downturn and we continue to believe that will be the case. I think that a true return to normal will occur not when any government policy changes, but when you're comfortable taking your 80-year-old parents into a crowded restaurant.

That's going to take a long time. You need a vaccine, which is a very long way off, or an effective therapeutic, that can actually be manufactured at scale, which will also take a long time, along with accurate and accessible fast testing. A lot of that fast testing we've seen recently is not particularly accurate.

We have one of the country's diagnostics experts as one of our operating partners. The public news you read about the diagnostic tests is somewhat misleading, given their actual accuracy.

We think this will last a long time with our true normal a year out. There are some businesses that'll start to get back to normal within three to four months, but for many of the businesses that were hard hit, it's going to be a much longer haul than people are assuming right now. I'm hoping I'm wrong on all of this.

Ben Magnano: I completely agree with what Tony said. One of the things we've been doing with our LPs is having a call every three weeks with our partners on the venture side of Frazier healthcare's business. Tachi Yamada, MD-PhD in public research, who was the Head of Healthcare for the Gates Foundation and one of our venture partners, would echo a lot of what Tony has just walked through, in terms of likely timing and when we get back to normal.

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I think everyone believes that there are going to be waves of this, hopefully not as deep and severe as what we're all going through now. But our stress test modeling contemplated five to six months of “non-normal.” If you ask me when we are going to get back to what we all knew to be normal in January/February of this year, I think it will be the back half of 2021 at the earliest.

Dan Agroskin: I’d like to take the optimist point of view, but I agree with Tony and Ben and think our return to normal is probably the latter part of 2021. The other thing you're dealing with is the general psychology across the population, and there is a lot of fear. Some of it is fact-based, some is not.

To have the psyche and the approach change overnight is not going to happen. Beyond all the numbers, it has a lot more to do with people's psychology, willingness and ability to get back to normal life, and that's just going to take a long time.

John Soden: The question that every client has for Cain Brothers is what do buyers need to see in order to pay a fair price? Is it one quarter of normal operation? Is it just visibility on when that normal level is likely to occur, even if it's 12 months out, or just having some competency to get back to that level?

Tony Davis: I think I'd like you to tell me, so I know when we can sell our businesses, but I think you've got to be at the point where there's a return to normalcy, and you've got to see a couple of quarters at a minimum. We're thinking, because we had a couple of sell sides that we pulled, and our view is that you're going to have to see a couple of quarters of a return to pre-COVID levels to be able to get the kind of evaluations.

At that point, who knows what the multiples are? We're obviously at the tail end of a decade-long boom with very, very high multiples. When you look back to the 2008-2009 time period, it took a few years for multiples to come back.

Ben Magnano: I completely agree with Tony’s comments. Additionally, getting a couple of quarters that look “more normal,” and we're all going to have this second quarter, whatever it looks like, in our trail. And as Cain Brothers advises folks on taking businesses out, it's going to be selling to a buyer group while you ignore the rat working its way through the python, if you buy the metaphor, to get this terrible quarter that we're all about to experience, out of the trailing numbers.

Dan Agroskin: I agree wholeheartedly. It'll just take time and I think Q2 is going to be very bad – worse than the general perceptions out there. As we look to Q3, it is hopefully going to be on the up-swing, but you don't just return overnight to kind of pre-COVID levels. It's very hard for that to happen.

You’re probably talking about not just one quarter of very bad results, but at least several and that will take time to work their way through the system.

John Soden: How do you think the healthcare private equity environment is going to change longer term? Is there a new normal that will follow from this?

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Ben Magnano: The thing that we're really focused on with our businesses right now is preparing testing capabilities so that we can safely reopen and certify to the public our patients and our customers, that they're entering a safe environment. I think that story or analogy around taking your parents to a restaurant is apt. Whatever that new normal is, everyone's going to have that thought in the back of their minds.

We're probably never going to see a clinical site again where there's busy waiting rooms and anyone can walk through a clinical operation that's busy, passing by other patients in close quarters. How you set that into your model is the question.

The other new normal question that I don't have an answer to, but we're trying to think through and doing some analyses around, is the payer community, both public and private, given the macroeconomic stress that the country is experiencing. That probably spells darker days for Medicaid funding, and by virtue of that, the reimbursement for commercial payers as well. It’s interesting with lots of different variables.

The open enrollment period later this year is probably going to be informative and different. What that means for how they choose to pay rates and the like in 2021 and beyond, these are all the things that we're trying to get our arms around and informing how we do our underwriting.

Dan Agroskin: Fundamentally, the reason we're all in the healthcare investing business is because it's a great end-market and all the macro trends that existed before the COVID hit, will persist in the post-COVID world. Those mega trends are going to continue to be multi-decade long trends, demographics, technical innovation, and pharmaceutical innovation. It's all in transit and the efficiency and the delivery of care will only improve.

The mega trends will continue. There's still a lot of cash on the sidelines wanting to invest in healthcare businesses. The fundamentals will still be there but it’s a question of how long it will take to get back to an environment that is somewhat normal. And that will take a bit of time.

Tony Davis: I agree with that. I think on an overall basis the trends are there, but I wonder how it will impact physician practice management or doctor deals and how quickly multiples will come back in those businesses.

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Ben joined Frazier Healthcare Partners in 2006. He represents Frazier on the boards of Caravel Autism Health, Comprehensive Pharmacy Services, Matrix Medical Network, Northfield Medical, Parata and United Derm Partners. Ben has been responsible for Frazier's successful investments in Ascension Orthopedics (acquired by Integra Lifesciences NASDAQ: IART), DSI Renal (merged with U.S. Renal Care and ultimately acquired by Bain Capital), Golden State Medical Supply (acquired by Court Square Capital Partners) and Laboratory Supply Company (acquired by McKesson NYSE: MCK). He also manages human capital recruitment for Frazier's Growth Buyout practice.

Prior to Frazier, Ben was an Associate at Morgan Stanley Partners (MSP), focusing on growth equity investing in the healthcare sector. Before joining MSP, he was an analyst in the healthcare investment banking group of Morgan Stanley. Earlier, he spent time at Arthur Andersen.

Ben is also an advisor for American Corporate Partners, a nationwide mentoring program dedicated to helping veterans transition to the private sector.

Mr. Magnano received his M.B.A from the Tuck School of Business at Dartmouth and his B.B.A from the University of Notre Dame.

Dan Agroskin joined JLL Partners in 2005 and serves as one of its Managing Partners and a member of the Investment Committee. Prior to joining JLL, Mr. Agroskin worked at J.P. Morgan Partners and in the Mergers & Acquisitions Group at Merrill Lynch. Mr. Agroskin earned a B.A. with distinction from Stanford University and an M.B.A. from the Wharton School at the University of Pennsylvania.

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Tony Davis is the President, a Managing Partner and Co-Founder of Linden Capital Partners. He has been involved in private equity and consulting since 1992. He currently serves on the boards of Advarra, ProPharma, Smile Doctors and Spear Education and is Chairman of the boards of Sage Dental and Virtus Pharmaceuticals. He previously served on the boards of directors for Behavioral Centers of America, Drayer Physical Therapy Institute, Focused Health Solutions, Ranir and Young Innovations. Additionally, Mr. Davis is a member of the Chicago Commonwealth Club, The Chicago Council on Global Affairs, The Commercial Club of Chicago and The Economic Club of Chicago. Tony is a Trustee of the Museum of Science and Industry and is a Director on the Northwestern Memorial Foundation Board of Directors and a member of the Northwestern Memorial Foundation Executive Committee. Tony was selected by the U.S. Department of Health and Human Services Deputy Secretary as a member of the Deputy Secretary's Innovation and Investment Summit (DSIIS).

Mr. Davis holds a Bachelor of Arts with honors in Economics from Northwestern University and an MBA with honors from the University of Chicago Booth School of Business, where he was a Rosett Scholar and serves on the Polsky Center Private Equity Council and as a guest lecturer on private equity.