

## Client Focus

### CLIENT PROFILE

Software entrepreneur  
Dave Cormack's  
healthcare solution turns  
into Deal of the Year

### EQUITY RESEARCH

Tech set to empower  
consumers to take control  
of their healthcare

## The Healthcare Debate: America's No. 1 Worry

What's next?



## Stocks Rally, Politics Cloud Outlook

Stock markets continued to push higher in the second quarter on optimism the Trump administration will deliver economic stimulus, tax reform and deregulation. Corporate earnings overall were strong and global markets in late May shrugged off Moody's credit-rating downgrade for China—the first in 28 years.

At the same time, concerns over political stability in Washington with investigations into the Trump campaign and Russian meddling in the 2016 election are keeping Congress distracted, stalling legislation. Many investors are focusing on what the Federal Reserve's promised interest rate hikes will mean for stocks and bonds in today's political environment. Rising protectionism also looms over trade.

Healthcare, as this issue of *Client Focus* explains, remains at the center of the U.S. political agenda. The struggles of Republicans to repeal and replace the 2010 Affordable Care Act will continue to hang over a complex and massive part of the economy—more than \$3 trillion in GDP in 2016. We look at key flash points ahead in the healthcare debate and zero in on the fundamental problem—soaring healthcare costs.

Healthcare touches not only thousands of companies but reaches into the homes of every American family. Our profile of software entrepreneur and William Blair client Dave Cormack illustrates how innovation and hard work are addressing costs, empowering patients and improving care.

William Blair advisors and analysts continue to watch the shifting horizon of healthcare for opportunities and red flags. Our latest overview of the sector and investment opportunities is our *Consumer-Centric Healthcare Report of 2017*.

I would also like to share news about our expanding wealth management teams. Ryan DeVore of private client advisors and John Brennan of investment counseling have led a rise in our private wealth assets under management by \$10 billion in the past four years. Our expansion in Boston, New York, and Atlanta has helped drive growth. Additional advisors are expected to join our offices in New York and Boston this summer.

We were delighted to celebrate the opening of our new global headquarters along the riverfront in Chicago on April 20. Chicago Mayor Rahm Emanuel and several hundred guests toasted our spectacular new tower which has received rave reviews from architectural critics around the country.

On behalf of everyone with William Blair, thank you for the trust you have placed in us. I hope you have a great summer and spend some extra time outdoors with your families and friends.

Sincerely,

John Ettelson  
President and CEO

# The Healthcare Debate

The American Health Care Act (AHCA) narrowly passed the House by a 217-to-213 vote May 9 and is now with the Senate. It will repeal and replace large portions of the Affordable Care Act (ACA) of 2010 and dramatically change the national healthcare system. But its fate is uncertain.

The first version of the AHCA, pulled by House Speaker Paul Ryan on March 24, was favored by only 17% of voters in a Gallup poll. The latest version of AHCA will make major cuts to Medicaid; allows states to seek waivers from providing certain benefits; and changes the subsidies for Americans who buy their own insurance. It also could affect Americans with preexisting medical conditions and employer-based insurance coverage. Some 23 million Americans could lose healthcare coverage over the next 10 years, according to Congressional Budget Office (CBO) estimates.

Senators have said they are going to take a hard look at the bill. The Republicans have a 52-member majority in the Senate. Republicans have pursued a parliamentary rule known as reconciliation so a bill could pass with a simple majority. But if the Senate makes broad policy changes, a revised AHCA may need a 60-vote threshold to pass.

So, there's only one thing certain now on healthcare: a long summer of political rhetoric.

But here we take a look at some flashpoints to watch as the healthcare debate continues. We zero in on

the fundamental problem with U.S. healthcare: its unsustainable price tag. Lastly, we will look at some companies that appear well placed to thrive in the evolving consumer-driven healthcare marketplace which many experts believe will reshape the system if it is to survive.

## Watch list

The ACA remains the law of the land until Congress votes to repeal it and President Donald Trump signs off.

Private insurers have until June 21 to decide where to sell their policies on the state marketplaces in 2018 and

what to charge. But uncertainty about whether the Trump administration will continue paying subsidies to low-income Americans to buy health insurance is making carriers hesitant about participating next year.

Trump in April backed off a threat to stop paying subsidies this year as part of a U.S. budget deal for fiscal 2017 ending September 30. But a big question mark remains over 2018.

The CBO in March said health exchanges in 2017 are likely to be "stable in most areas." Some big insurers like Aetna, however, have fled

## Health and Risk Factors by Country

	Life expectancy at birth	% population obesity rate	% population daily smokers	% population age 65+
<b>United States</b>	78.8	38.2	12.9	14.9
<b>Sweden</b>	82.3	14	11.9	19.6
<b>Japan</b>	83.7	3.9	19.6	26.7
<b>Germany</b>	81.2	23.6	20.9	21
<b>Denmark</b>	80.8	14.9	17	18.6
<b>Canada</b>	81.5	25.8	14	16.1
<b>United Kingdom</b>	81.4	25.6	19	17.7

Source: OECD Health Data 2016



the exchanges, citing losses. But most insurers' 2016 results were better than 2015, according to an S&P Global Ratings report released in April. "The 2016 results and the market enrollment so far in 2017 show that the ACA individual market is not in a death spiral," S&P said.

"It's very much a conundrum—and the sooner it's resolved the more certainty carriers will have with regards to 2018," Sara Collins with the Commonwealth Fund, a private foundation that promotes high-performing healthcare systems, said of the subsidy question. "This is the biggest issue confronting the marketplaces."

Another key to watch is the states.

While the revised House AHCA bill allows states to apply for waivers that give them more flexibility in managing Medicaid programs, there are signs the Trump administration is already moving in that direction.

Seema Verma, the new head of the Centers for Medicare & Medicaid Services (CMS), which approves Medicaid waivers, said during congressional testimony that the agency will bring in "a new era of state flexibility and leadership."

Kentucky is a state to watch as it could be the first state to reduce healthcare costs by lowering Medicaid participants. CMS is reviewing a waiver from Kentucky to restrict Medicaid eligibility.

But Republican governors like Ohio's John Kasich, who accepted the ACA's expanded funding for Medicaid, are lobbying the Senate to expand, not reduce, Medicaid funding. The House-passed AHCA cuts about \$800 billion in Medicaid funding over 10 years.

### Rising healthcare costs

So the seven-year debate over the ACA goes on while Americans struggle with the rising cost of healthcare, which in 2016 accounted for 18% of GDP—\$3 trillion.

U.S. health spending is nearly \$10,000 per person a year, more than double that of any comparable country, according to the CMS's latest report. But American life expectancy is lagging most of the world's largest economies.

"There's a root issue here that we have to address: it goes back to the high cost of healthcare in the United States," says Ryan Daniels, a William Blair

equity analyst who covers the healthcare sector. "That's why people don't have health insurance. It's unaffordable."

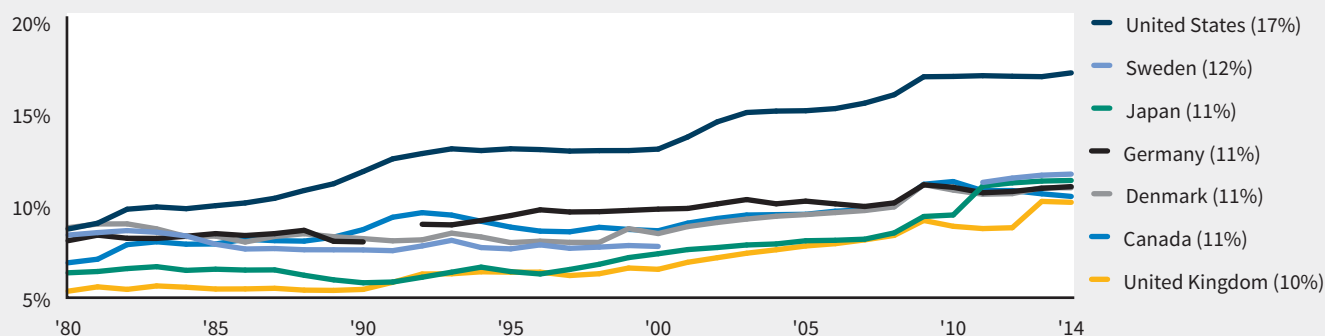
Many drug prices are out of control. The cost of surgery varies radically across the country. Hospitals are not communicating with insurance companies, resulting in health problems getting worse and costing more to help. The list goes on.

"It's an amazingly inefficient market. That's what happens when there is no price transparency," Daniels says. "You are not paying directly the one providing your care. Thus, it is a broken marketplace in many regards."

### Consumers, technology driving change

That's why many experts are now trying to change healthcare from a fee-for-service model—one that pays doctors and hospitals for every service they perform or device they use—to a fee-for-value market, one where consumers have more control over their healthcare decisions, behavior, and results. The vision is a marketplace where providers are rewarded for the value of, not amount of, services provided.

## Healthcare Spending as a Percentage of GDP, 1980–2014



Note: Germany and Japan data is for current spending only and excludes spending on capital formation of health care providers.

Source: OECD Health Data 2016.

## Online Services, Big Data Driving Care

In 2016, for example, 20 companies united to form the Health Transformation Alliance (HTA) to help fix the “broken healthcare system.” The group has expanded to 38 companies that collectively spend more than \$24 billion annually on healthcare costs.

“While it’s not yet clear what actions the federal government will take, we are working together toward a clear path to positively change healthcare for tens of millions of people in the private sector,” HTA Chairman Kevin Cox said in March when he announced partnerships with CVS Health and OptumRx to improve price transparency and cut drug costs.

**“It will be technology innovation spurred by consumerism that will help drive down costs,” Daniels says.**

Retailers are also beginning to lead change. Walmart has opened walk-in clinics where consumers pay a flat fee for services from flu and colds to sprains and vaccinations. More doctor groups now offer “urgent” or “immediate” care centers for walk-in patients that are significantly cheaper and quicker than an emergency room visit.

Tech companies are also responding to consumer demand with mobile apps such as Teladoc, DoctorOnDemand, and MDLIVE that let patients explore the emerging world of “telehealth”—finding a doctor and requesting virtual consultations, comparing the costs of care across different healthcare settings, and promoting wellness.

Among healthcare providers there also is significant interest in harnessing big data to analyze performance of health facilities, drugs, and procedures in order to improve patient care. The ACA has already spawned careful data mining among providers through Medicare reforms such as penalizing hospitals for readmitting patients within 90 days of when they left the hospital due to poor care.

“It will be technology innovation spurred by consumerism that will help drive down costs,” Daniels says.

Everywhere we look in healthcare, we see the wonders of technology—from digital imaging to laser surgery, DNA testing to organ transplants.

So as one would expect, innovative technology is a big driver of the soaring cost of healthcare. But analysts also see it as a force to drive costs lower.

A case in point: “soft tech” from mobile apps, smartphones, and big data are now revolutionizing the healthcare industry, empowering consumers to take control of their care and expenses, says William Blair equity research analyst Ryan Daniels.

“Consumers, in tandem with disruptive technology and service providers, are the key to solving many of healthcare’s woes, particularly the unsustainably high cost of care in the United States,” Daniels says in William Blair’s annual *Consumer-Centric Healthcare Report of 2017*.

“Companies that understand the need to offer these types of benefits to patients will win in this healthcare revolution,” he says.

Daniels points to companies investors should watch, such as telehealth provider Teladoc and healthcare technology vendors such as Cerner, Premier Inc., and Evolent Health.

Evolent Health, William Blair’s 2017 top stock pick for healthcare technology, has a track record of providing hospitals and doctors with the consulting, technology, and ongoing services to help them transition from a fee-for-service care model to one that rewards low-cost, high-quality care.

In addition, employers are pushing greater responsibility for health maintenance onto their employees via wellness programs. Employers also are seeing more employee interest in high-deductible insurance plans paired with health savings accounts—the fastest-growing insurance vehicle in the commercial marketplace over the past decade.

“We believe that investors in both the public and private-equity markets will achieve superior long-term returns by identifying and investing in these organizations,” Daniels says.

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# Brightree: Tech Innovation Fuels Sustainable Health

*Mergers & Acquisitions* named ResMed's purchase of Brightree "Deal of the Year" for 2016.



Dave Cormack

Business entrepreneur Dave Cormack has always seen the value in being connected—suppliers with customers, consumers with products, systems with each other.

So when he evaluated a distressed home medical equipment software company, he saw an opportunity to invest in developing its product, Brightree, and bring in an all-star leadership team. The goal: connect a fragmented industry of 8,000 small to midsize homecare providers poorly served by existing software. His instincts once again proved correct.

Cormack took over privately held Brightree as president and CEO in January 2005, when annual sales were \$500,000 and the company had 12 employees. It had come very close to closing the business. By 2016, sales had grown to \$135 million, staff had grown to 500 employees, and EBITDA had grown to \$55 million. That success drew a lot of fans including ResMed, a global maker of products for sleep disorders. In early 2016, Cormack led the sale of Brightree to ResMed for \$800 million in cash.

The transaction was named "Deal of the Year" for 2016 by *Mergers & Acquisitions* magazine. William Blair's healthcare IT team of Karl Palasz, John Kibler and Manny Chavez were Brightree's exclusive financial advisors on the deal.

"The purchase underscores the ongoing shift in the U.S. healthcare system from a fee-for-service model to a fee-for-value model and the need for players across the healthcare continuum to use informatics and data analytics as tools to share information and deliver care more efficiently," *M&A* said in April 2017.

Before Cormack arrived, Brightree was conceived by home medical equipment industry veterans Steve Elrod and Jerry Lippincott, who had managed and acquired several providers—each with its own computers, networks, and software. This made it tough for the systems to communicate with one another. They had the vision to design a system to manage the workflow from order intake to cash posting across one software platform that could plug into the internet, i.e., "the cloud."

With such a platform (now commonly termed "software as a service," or SaaS), the home medical industry's thousands of small businesses no longer have to host, maintain, or upgrade their software or servers. They don't have to worry about the "network." They just plug in and play using the Brightree SaaS platform.

"It was a great idea but an early-stage business," Cormack says. "The challenge they had was expecting a healthcare management team to be

able to drive a fast-growth software company.”

Cormack, a veteran software entrepreneur, and his business partner Rick Chitty had been advising Brightree for months before they concluded their purchase in December 2004.

“We thought there was a real opportunity. There was no clear leader and an internet platform would be the route forward for these small businesses,” Cormack says.

With hard work, innovation, a sales-driven culture, and a group of dedicated team members, Brightree re-launched its SaaS platform for small to midsize home medical equipment providers in Fall 2005.

Brightree was able to deliver an automated system from order intake to auto-posting reimbursement of

payments from Medicare, Medicaid, and thousands of commercial medical insurers, allowing providers to get paid faster and improve margins.

#### **Future of U.S. Healthcare**

Today Brightree is also a leading software provider in the home health and hospice industries. It manages back-office services and clinical point-of-care, where a nurse with an iPad can quickly assess a patient’s needs and create a plan of care. Such innovation across the healthcare industry needs to grow, Cormack says.

“In 20 years’ time U.S. healthcare will be 35% of GDP unchecked,” Cormack says. “And that’s unsustainable.”

Cormack sees the U.S. healthcare system in the next 10 years moving from today’s fee-for-service model to one where payments will be based on the positive outcome of a patient’s

experience. If a doctor has a 20% success rate on knee operations, Cormack says, he’s going to be out of business because he’s not going to be paid on the 100% like he is today.

“That’s a way of controlling costs and providing much better patient care for the consumer,” Cormack says.

Basic to creating such a consumer-centered system, he says, is the investment in technology that can seamlessly link the three main sectors of the U.S. healthcare industry—hospitals and care facilities, physician practices, and homecare providers.

“Still today none of these systems talk to each other,” Cormack says.

“So the technology opportunity is tying those three systems together—taking on a holistic approach to caring for a patient.”

## Becoming a Software Guru



William Blair client Dave Cormack left homecare software firm Brightree at the end of 2016 after transitioning to the new management team. Today, he is back scouting for investments in the software market. But Cormack is also spending much of his time working with the family charitable foundation he and his wife Fiona established.

The Cormacks give generously to charities in their hometown of Aberdeen, Scotland. They helped open a medical facility there—a Maggie’s Cancer Centre—and support the Aberdeen Football Club Community Trust.

But a special cause for them has become Children International (CI), a nonprofit based in Kansas City that fights global poverty. The Cormacks funded two CI community centers in Cartagena, Colombia, which serve 12,000 children in poverty. The centers are safe havens for children to receive dental and healthcare, learn English, and learn job skills.

“The difference there is being a street vendor earning \$100 a month or \$700 at a hotel because you speak English,” Cormack says.

The Cormacks moved to the U.S. from London in 1995 when Dave sold his software business, Soft Systems, to Atlanta-based IQ Software. Today they split their time between Scotland and United States.

Cormack began his career in Aberdeen’s oil industry working his way through college. He learned computerized reporting systems there and in 1986 moved to London, Europe’s software hub.

Thinking about his success with Brightree, Cormack says he remains especially thankful for the team members who stayed with him for years. They were key to Brightree’s success and he took pleasure in sharing the profits of the ResMed sale with them.

“From where I come from it’s an amazing journey and we’ve been blessed,” Cormack says. “If anyone says the American dream is dead, they just need to call me.”



*William Blair*

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## CLIENT SERVICE

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Your financial advisor will provide you with log-in credentials and walk you through the easy steps to Get Connected. Call today!



### Chicago Headquarters Moving This Summer

We are moving into our new Chicago offices at 150 North Riverside Plaza over the summer. The move will be completed by July 31. Our new global headquarters, which reflects five years of research and planning to create a state of the art space, will support the firm as it grows and evolves. The new offices were designed to encourage collaboration and provide a welcoming environment to host clients. We look forward to meeting with you at 150 North Riverside this summer and beyond.