

SPOTLIGHT

Sio Capital's Michael Castor on Healthcare Investing From a Medical Doctor's Viewpoint

Sio Capital Management LLC Founder **Michael Castor** sat down with Bloomberg's Nathaniel Baker to discuss his healthcare-focused long/short equities strategy, how his training as a medical doctor influences his stock-picking and what might happen when the U.S. Supreme Court decides on the fate of Obamacare this week.

Q: Your fund is long/short equity with a focus on healthcare. How do you go about picking stocks?

A: It's a fundamental approach. We target diverse types of investments. The majority of our investments, especially our longs, have a history of earnings and cashflow. We also look at science-focused companies. Sometimes those present good opportunities.

Q: You're an M.D. How, if at all, does your training as a doctor help your methods?

A: It can be a double-edged sword. I can approach a company that is science-based and I've got the vocabulary and the statistics background to understand their data or products. But there's a potential for doctors in general to rely too heavily on their own experience, which might not be representative. I always have to make sure I'm not interjecting too much of my personal bias. I think doctors have a risk of becoming enamored of science. Many early-stage drugs would be promising – if they work. My job is to look for all the reasons they won't work. Most early-stage drugs fail.

Q: How much of the portfolio is dedicated to such early-stage companies?

A: Roughly 10 percent. Our portfolio tends to be about 60 names, 30 long, 30 short.

Q: Let's talk about secular trends in healthcare, specifically Obamacare?

A: The President's initial goal was to expand coverage and control these skyrocketing costs. The law that passed does not do much to control costs. The biggest impact will be to expand insurance coverage from about 85 percent now to about 95 percent, covering an incremental 30 million Americans. The law provides

for numerous taxes to pay for this expansion and for the necessary government subsidies. The effect on public companies is likely to be limited. There will be a small increase in utilization offset by small cuts in reimbursement. In aggregate, it's not a big shift from the system other than to mandate that people get insurance. And of course we'll see very soon in what form this law is upheld by the Supreme Court.

Q: Where does that stand?

A: The central question is: does the government have the right to force people to do something? In this case it would be forcing them to buy insurance? Four justices have expressed support for the law and four have indicated they are against it. Justice Anthony Kennedy will be the swing vote.

Q: What do you think he'll do?

A: I do not know. He's known to have strong beliefs about protecting individual liberty. His questions to the solicitors seemed to indicate skepticism about the constitutionality of the mandate. The critical decision will be whether to strike just the mandate, the entire law, or selective parts of the law. I don't think anybody will know the answer until the decision is rendered.

Q: Let's go back to your portfolio. Do you have any favorite positions?

A: I'm excited about my shorts. I have several long investments that I like, but longs are harder to find.

Q: Why are you excited about the shorts?

A: The shorts I'm most excited about are the ones where we have identified impactful catalysts. Valuations are extremely rich and have been getting richer. This suggests to me that there is enthusiasm and lofty expectations on the part of investors. Such stocks tend to see big price declines if the companies miss investor expectations.

Q: Names?

A: Cerner (CERN), despite being a great company, is one. They make electronic medical records. There's a government mandate that requires doctors and hospitals to implement these systems. The government even offers incentive payments to providers for installing systems. Cerner has reported 20 percent revenue growth. We believe customers accelerated purchases to get incentive payments. We expect a slowdown in revenue growth, while Wall Street forecasts continuation of the trend. We look forward to upcoming earnings calls to find out if we're correct.

Q: How about longs?

A: We have good representation of quality, large-cap names in our long book. Two examples are JNJ and AMGN. Smaller longs that I think are particularly interesting and a little bit off the beaten path are Air Methods (AIRM), which operates helicopter emergency transport services. Pharmacyclics (PCYC), a company that is developing a drug to treat leukemia. Orthofix (OFIX), a medical device company with a specialization in orthopedic implants and focus on therapies that help heal spinal bones that are operated on.

AT A GLANCE



Age: 41

Hometown: Akron, Ohio

Residence: New York

Education: Tulane University (BS.E), Ohio State (M.D.)

Professional Background: JPMorgan, Bernstein Investment Management and Research, Sio since 2006.

Mentor: Lew Sanders

Favorite New York City Restaurant: Erminia