HEALTHCARE DEAL ADVISORY SERVICES

Healthcare M&A Insights

Resiliency and Opportunity Drive Deal Activity

Cherry Bekaert LLP
CPAs & Advisors

Overview

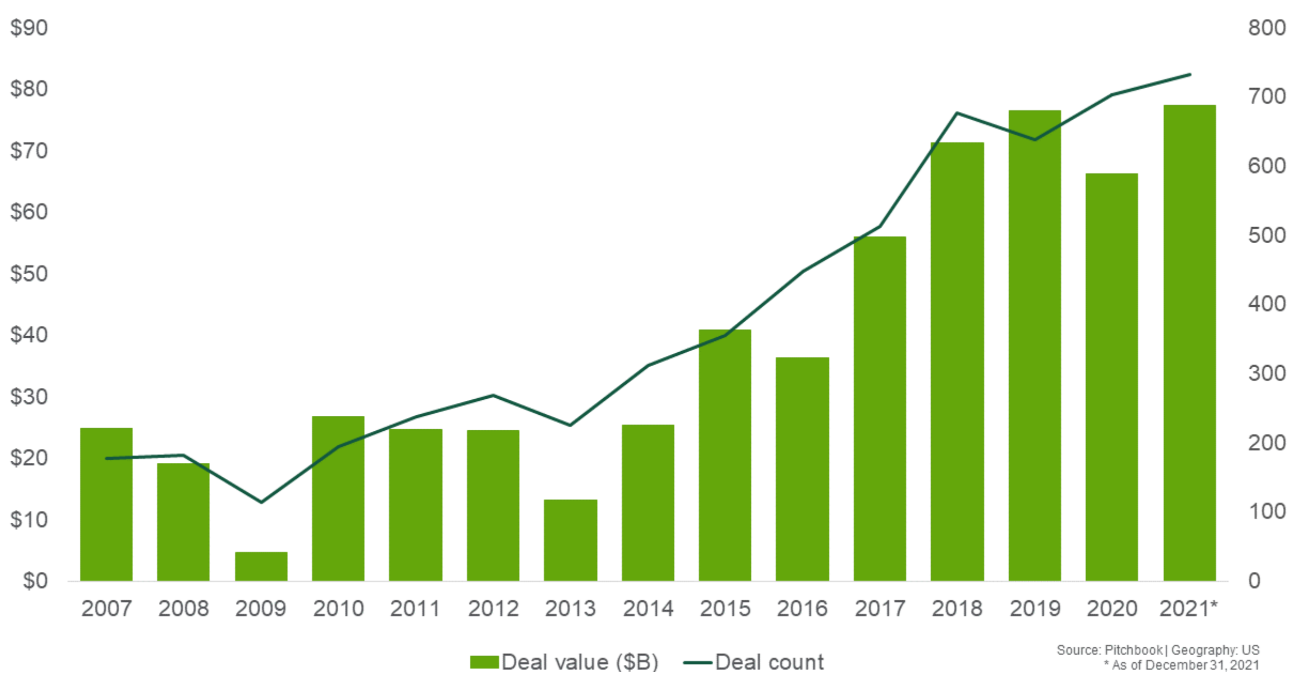
The COVID-19 pandemic has affected the healthcare sector in unprecedented and multifaceted ways, and two years in, its impact is still transforming the industry. In 2021, we saw investment in new technologies and delivery models—especially digital health—evolve to meet the demands driven by the pandemic. We also saw smaller providers seeking to partner with larger practices to avoid potential future financial and operational impacts. In addition, physicians, like many other private company owners, were incentivized to sell before year-end to avoid an anticipated increase in the capital gains tax – one that has yet to materialize.

Private capital has long been an important source of financing in the healthcare industry, providing a critical source of innovation and investment. In 2021, private equity investment in healthcare continued to both expand and become more sophisticated as firms sought to position themselves on the right side of changes in the industry. Some of the hottest specialty areas included behavioral health, orthopedics, ophthalmology, dental (several sub-sectors), gastroenterology, and various women's health services.

M&A activity involving telehealth providers sky-rocketed during late 2020 and through 2021, fueled by the inaccessibility to mental health providers during COVID-19 quarantines, and the relaxing of requirements by payors for reimbursement of telehealth services. However, the jury is still out on the long-term sustainability of pure play telehealth companies. Going forward, many believe it will be those providers with a combination of in-person and telehealth visits that will be the most successful. Under this model patients can develop a personal bond with their provider through physical visits, while obtaining easier access to more routine services through telehealth. In addition, the continuing adoption of remote monitoring devices has become critical to providing healthcare services remotely.

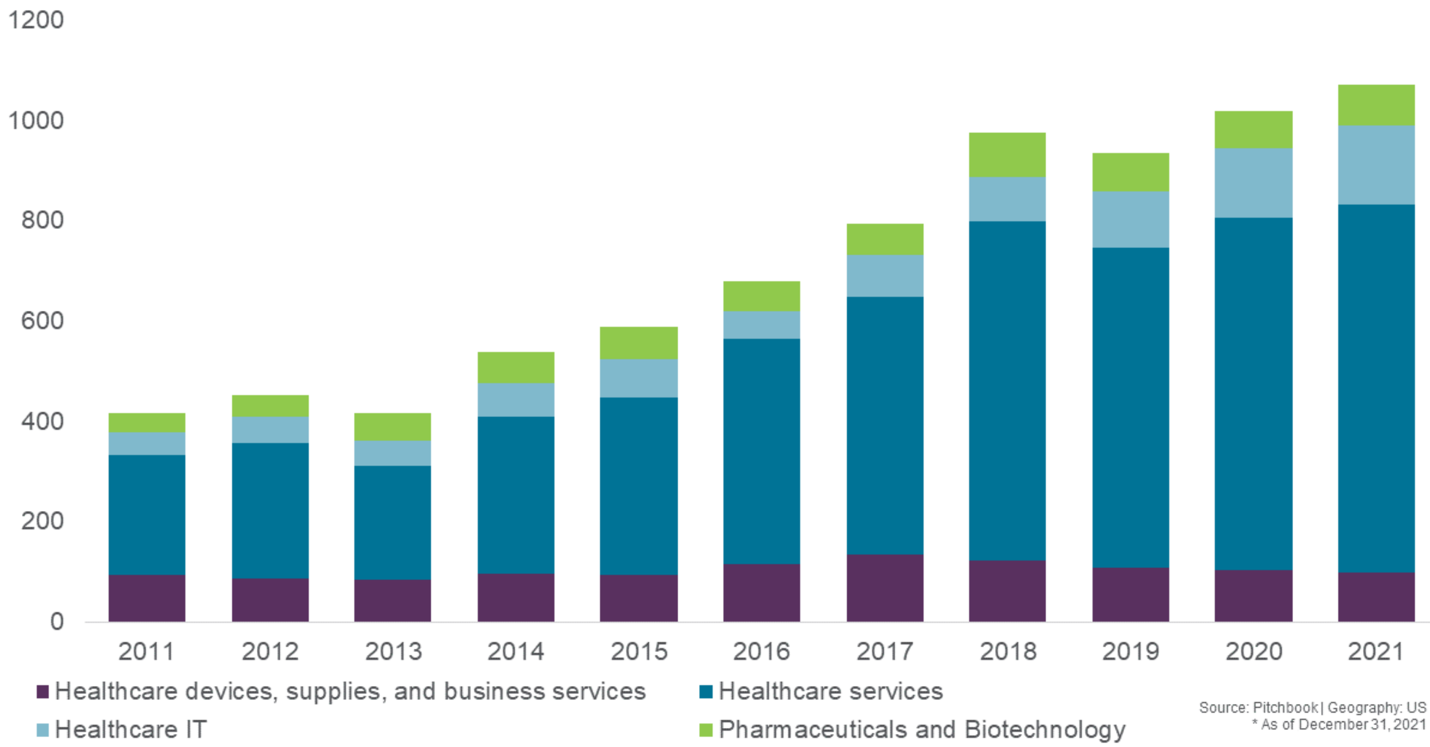
With a growing elderly population and an increasing number of people with chronic diseases, the industry is a prime candidate for new investment. The growth in healthcare private equity investments has accelerated in the last few years, with an influx of new players. However, healthcare private equity investments are a complex business. There are numerous risks and opportunities, so taking risks in healthcare is essential for private equity firms to succeed. This has made it essential for fund managers to have the right experience and expertise to provide the best guidance to increase the likelihood of success, mitigate risks, and maximize returns on investment.

US Healthcare Services PE Deal Activity



Source: Pitchbook | Geography: US
* As of December 31, 2021

US Healthcare PE Deal Count by Category



> The appetite for investment in healthcare has grown year-over-year for going on a decade now. This trend is likely to continue into the foreseeable future, due to the favorable drivers of growth in the sector."

- Steve Stang, *Cherry Bekaert Partner and Healthcare Deal Advisory Leader*

Healthcare private equity funds come in many forms, including growth equity firms and traditional private equity firms, and they are investing in businesses that offer high growth potential. These investors are focused on growth prospects and value creation. They are looking for companies that can capitalize on this growth. As such, private equity firms are actively seeking new and innovative companies to grow and improve. While the investment opportunities in the healthcare industry are abundant, the key to thriving in this sector is identifying the right targets. It is essential to have a comprehensive understanding of the sector and the unique challenges it faces.

Private equity funds that specialize and have a deep healthcare knowledge base will likely be the ones to provide investors the largest returns. Successful healthcare-focused private equity funds, particularly those focused on healthcare services, have been able to navigate the complex regulatory environment of the sector while capitalizing on buy and build strategies.

2021 Year in Review: Banner Year in Healthcare M&A

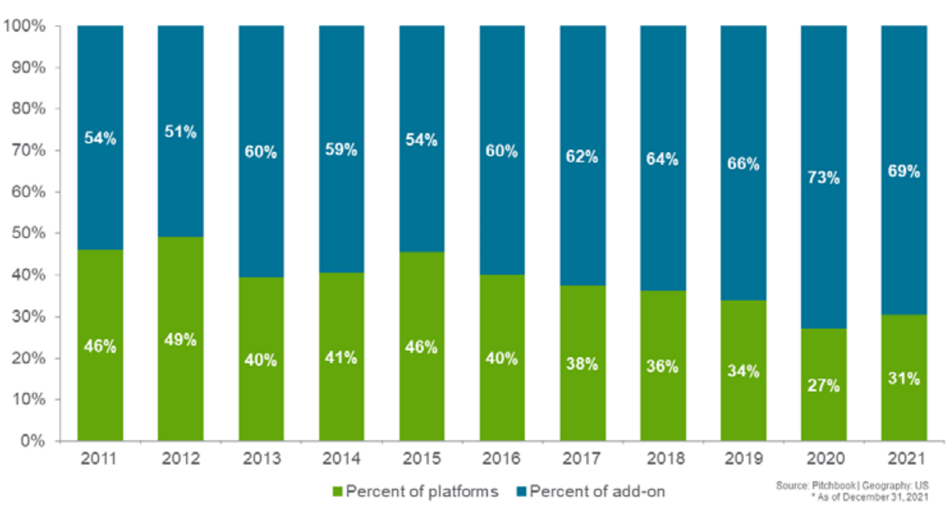
The U.S. healthcare market showed its resilience in 2021, responding to the ongoing COVID-19 pandemic with technological innovation and a reimagining of healthcare services delivery. Private equity funds took note and looked to take advantage of near perfect economic conditions which resulted in a record number of deals completed and the highest aggregate transaction value ever recorded (approximately $78 billion, eclipsing 2019, the previous record year for dealmaking) in the healthcare services sector.

US M&A Healthcare Services Deal Activity

Healthcare Services

Almost every healthcare industry sector experienced an increase in deal activity, where a record 1,149 M&A transactions were completed, with aggregate transaction value exceeding $126 billion. Private equity investments in healthcare services accounted for the largest share of deal activity, with more than 730 transactions completed in 2021. The healthcare services sector—which includes segments such as orthopedics, behavioral health, dentistry, and vision—experienced a significant uptick in deal activity in 2021. In addition, private equity has long been interested in Ambulatory Surgery Centers (ASCs), which are expected to continue hosting a growing proportion of surgeries because they offer lower costs than hospitals and are often more convenient for patients. Increasing demand for elective surgeries, coupled with other outpatient surgeries moving to ASCs, signal future revenue growth opportunities. A large portion of the overall increased volume was represented by add-on deals, which provide the opportunity to grow, professionalize many business functions, and realize economies of scale. These factors ultimately lead to improvements in business performance and increased valuations in the sector.

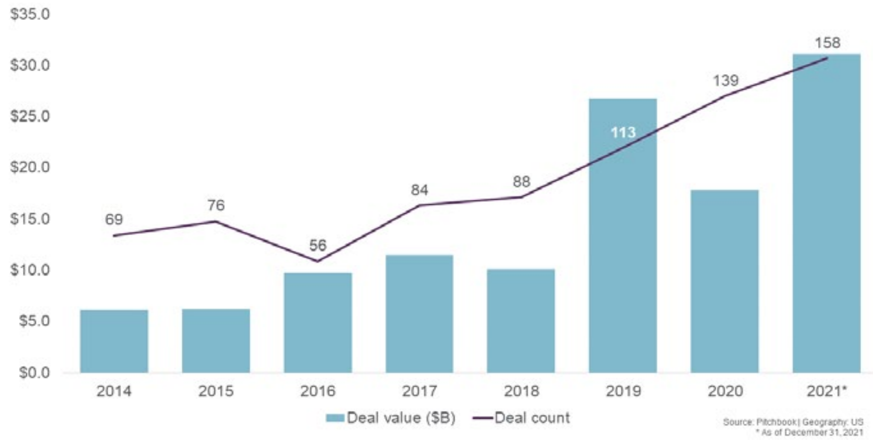
Add-ons as a Percentage of US Healthcare Services Deal Activity



Healthcare Technology

Digital health, or healthtech, is a wide-ranging sector that includes telemedicine, data analytics, clinical decision support, mobile health, artificial intelligence (AI) for drug discovery, and remote patient monitoring. Healthtech is one of the fastest-growing verticals within healthcare as the demand for digital tools continues to climb. According to PitchBook, private equity investment in healthtech companies in 2021 rose to more than $5.4 billion on 67 deals, up from $1.75 billion on 38 deals in 2020. Two of the largest areas for healthtech are electronic health record (EHR) software and revenue cycle management software. Although a few large players dominate the hospital EHR market, firms are seeking growth opportunities with EHR vendors that cater to smaller but less saturated segments of the healthcare provider landscape. The most prominent recent example of this is the announced $17 billion buyout of Athenahealth, a provider of cloud-based enterprise software solutions for medical groups and health systems, by Hellman & Friedman, Bain Capital, and GIC. Advances in digital technology, as well as changes in patient behavior during the pandemic, have exposed longstanding inefficiencies and inequities in the U.S. healthcare system, which has created a significant opportunity for private equity to power healthcare's digitalization revolution.

US Healthcare Technology Systems PE Deal Activity



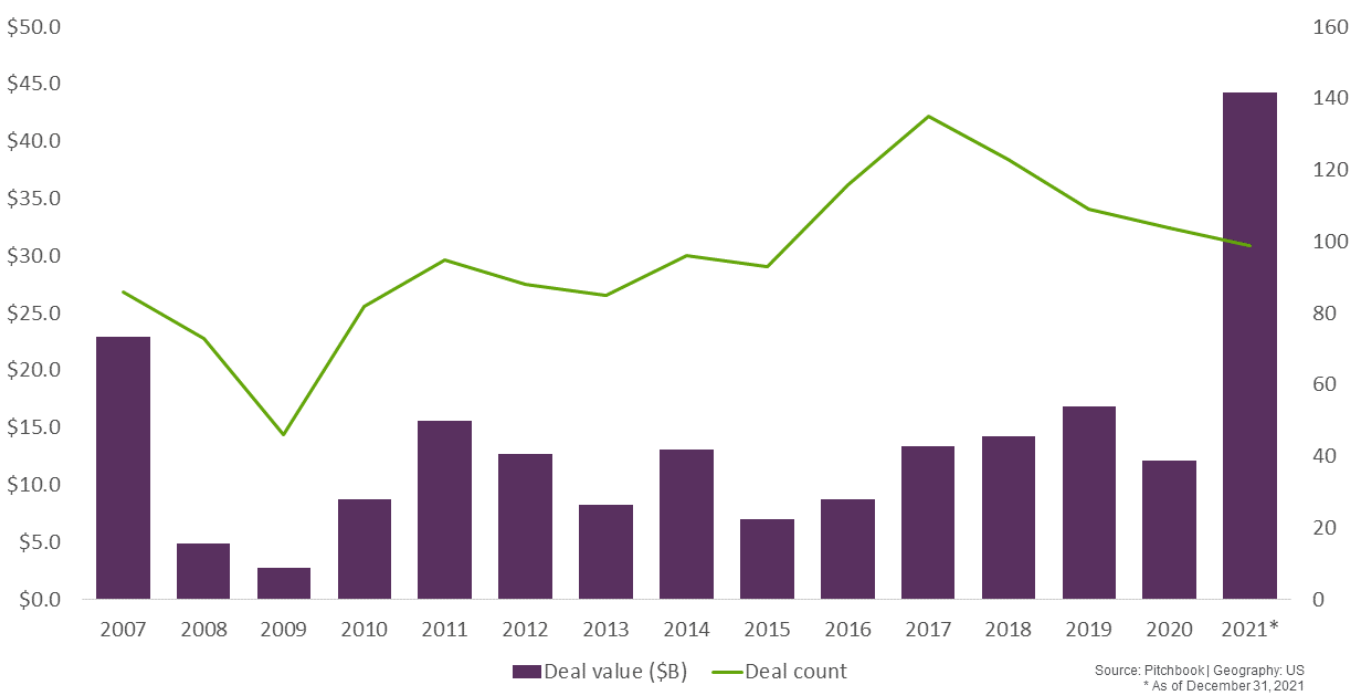
Devices, Supplies and Business Services

Approximately $44 billion was invested in healthcare devices, supplies and business services, a record which more than tripled the amount invested in 2020. Across all of healthcare, companies are taking advantage of abundant capital, both in private markets and via the rise of special purpose acquisition companies (SPACs). Medtech players in particular are motivated to gain scale as defense against reimbursement pressures as well as to accelerate revenue generation by investing in high-growth areas. Due to various factors, including continued demand related to the distribution and administration of COVID-19 vaccines, it is expected that deal activity in this sector will remain high for the foreseeable future.

Pharmaceuticals and Biotechnology

In the life sciences space, 2021 saw the largest-ever buyout of a pharmaceutical company when EQT (STO: EQT) purchased contract research organization (CRO) Parexel International for $8.5 billion with Goldman Sachs Asset Management (GSAM - NYSE: GS) as a minority investor. Deals for mature life sciences companies are traditionally dominated by cash rich pharmaceutical giants. However, EQT has established itself as the leading large firm in the space and, on the heels of its impressive $9.6 billion exit of Aldevron and acquisition of venture firm Life Sciences Partners, will likely continue this trajectory.

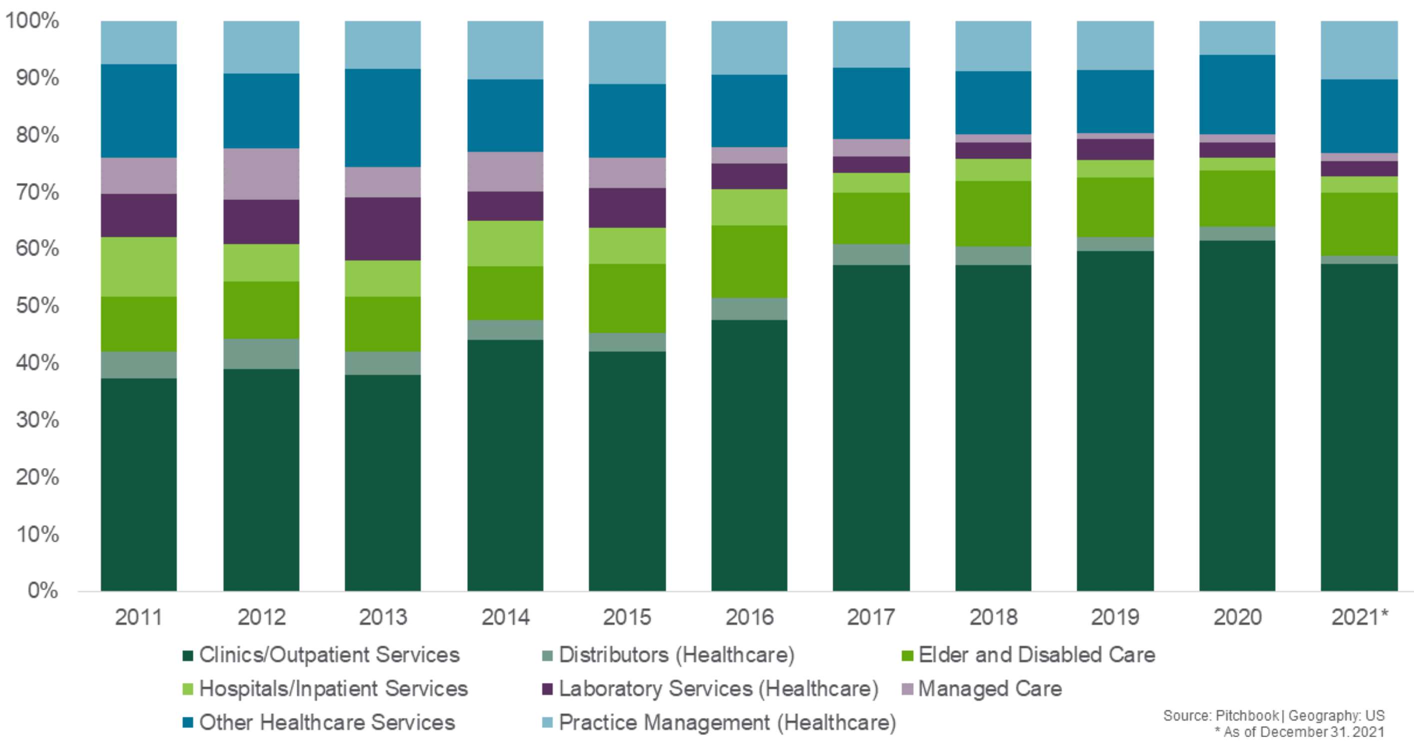
US Healthcare Devices, Supplies, Distribution & Business Services PE Activity



Hot Segments in Healthcare

One of the primary themes we continue to see in healthcare is consolidation across fragmented provider segments. In 2021, of an estimated 730 private equity deals in healthcare services, approximately 57% focused on providers in the clinic and outpatient services segment.

US PE Healthcare Deal Activity by Sub-segments *(by number of deals)*

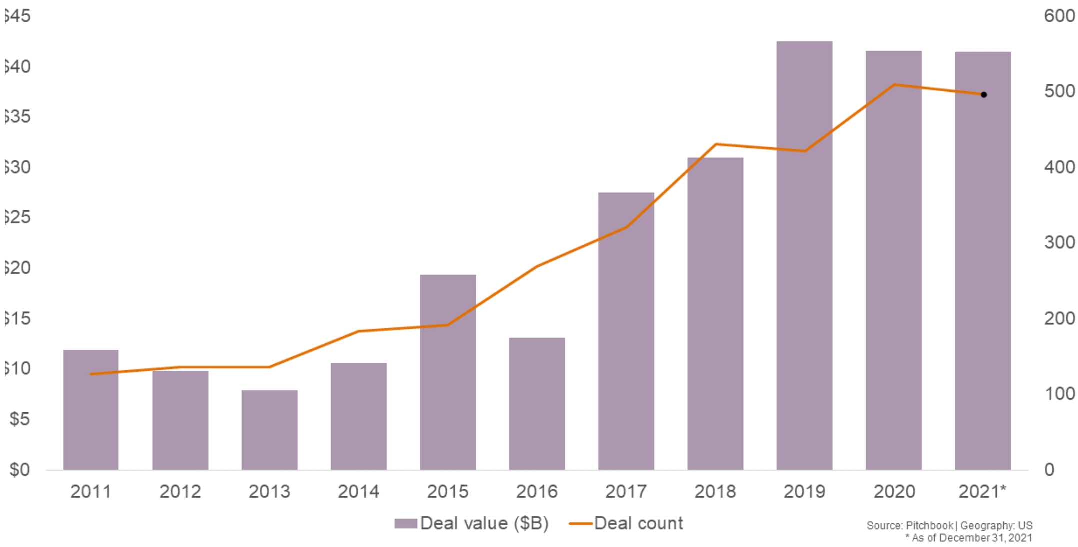


Additionally, almost 70% of these deals represented add-on activity for existing private equity backed platforms. Specifically, private equity activity remains strong in ophthalmology, optometry, behavioral health, general dentistry, specialty dentistry, veterinary medicine, and aesthetic dermatology. As existing funds continue to grow their platforms, new entrants are increasing competition for targets as they seek accelerated growth.

Provider platforms originally built through add-ons of smaller sized acquisitions (one to three providers) are now targeting larger provider groups to grow existing platforms faster. These larger targets represent groups that were previously rolled up, both with and without private equity backing, and are now seeking an exit. Anecdotally, we are seeing this add-on trend play out among our private equity clients, with some platforms recently closing and signing up deals which roughly mirror the size of their existing platform in terms of the number of providers. As competition in this segment is expected to remain elevated, this trend will likely continue in an effort for platforms to gain market share faster.

As lower and middle-market funds continue to drive provider consolidation, the expected increase in the number of larger private equity-backed platforms seeking to test the public markets is validating these fund's investment theses. According to Pitchbook, a record 10 or more U.S. private equity-backed healthcare provider platforms are expected to list publicly in 2022, up from six in 2021.

US Healthcare Services PE Add-On Deal Activity



On the provider side, the managed service organization (MSO) and dental service organization (DSO) models are being embraced by practitioners who view this trend as an opportunity to increase their focus on delivering care, to drive higher operating margins and to monetize the practices they have built through an attractive exit valuation. These models have proven to perform well in both growth and recessionary environments, which is why it is estimated that several thousand providers in these fragmented markets will look to join some form of a service organization over the next few years.

Additionally, as the continued adoption of value-based care (VBC) delivery accelerates the shift in how care is provided to consumers, we expect VBC reimbursement models to play a larger role in private equity transactions than they have historically. Over the last decade, proof of concept experiments among larger healthcare organizations have laid the groundwork for greater adoption at the provider level with the overall goal of improving outcomes while driving down the overall cost of delivery.

Looking Into the Future

Healthcare is one of the most important industries world-wide. The industry is not only large, but it is also diverse and fragmented. Recently, the healthcare industry has been undergoing a major transformation. The latest COVID-19 reports, along with the strong deal activity and investments in the sector have confirmed the resilient, and even opportunistic, nature of healthcare during these difficult times. In addition, the pace of technological innovation and new service offerings continues to accelerate. In fact, the development of COVID-19 vaccines and having them dispersed to patients in just a matter of months—instead of years—may be the most important medical advancement in decades.

While investment in different sectors of healthcare tends to be cyclical, investment in the overall industry continues to grow at a significant pace. Notwithstanding other forthcoming external factors such as rising interest rates, we believe 2022 will be another exceptional year for healthcare deals. We will likely see increased growth in some sectors like home health and dental, and lower activity in certain sectors that have traditionally been hot the past few years. We also expect ophthalmology, and physician management companies will continue at a strong pace.

About Cherry Bekaert's Healthcare & Life Sciences Deal Advisory Practice

Cherry Bekaert's National Healthcare & Life Sciences Deal Advisory Practice is uniquely positioned at the intersection of our Private Equity and Healthcare & Life Sciences practices. This means your Healthcare & Life Sciences transactions team not only has extensive deal experience, but also possesses in-depth expertise of the healthcare and life sciences segment. As a result, we enhance the efficiency and value of every healthcare transaction at each stage of the deal with our industry-unique, 100% healthcare & life sciences and private equity-led team.

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Healthcare & Life Sciences Deal Advisory

2021

168 Total Deals

143 Buy Side

25 Sell Side

$3.9 Billion in Transaction Value

cbh.com/privateequity

About Cherry Bekaert

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