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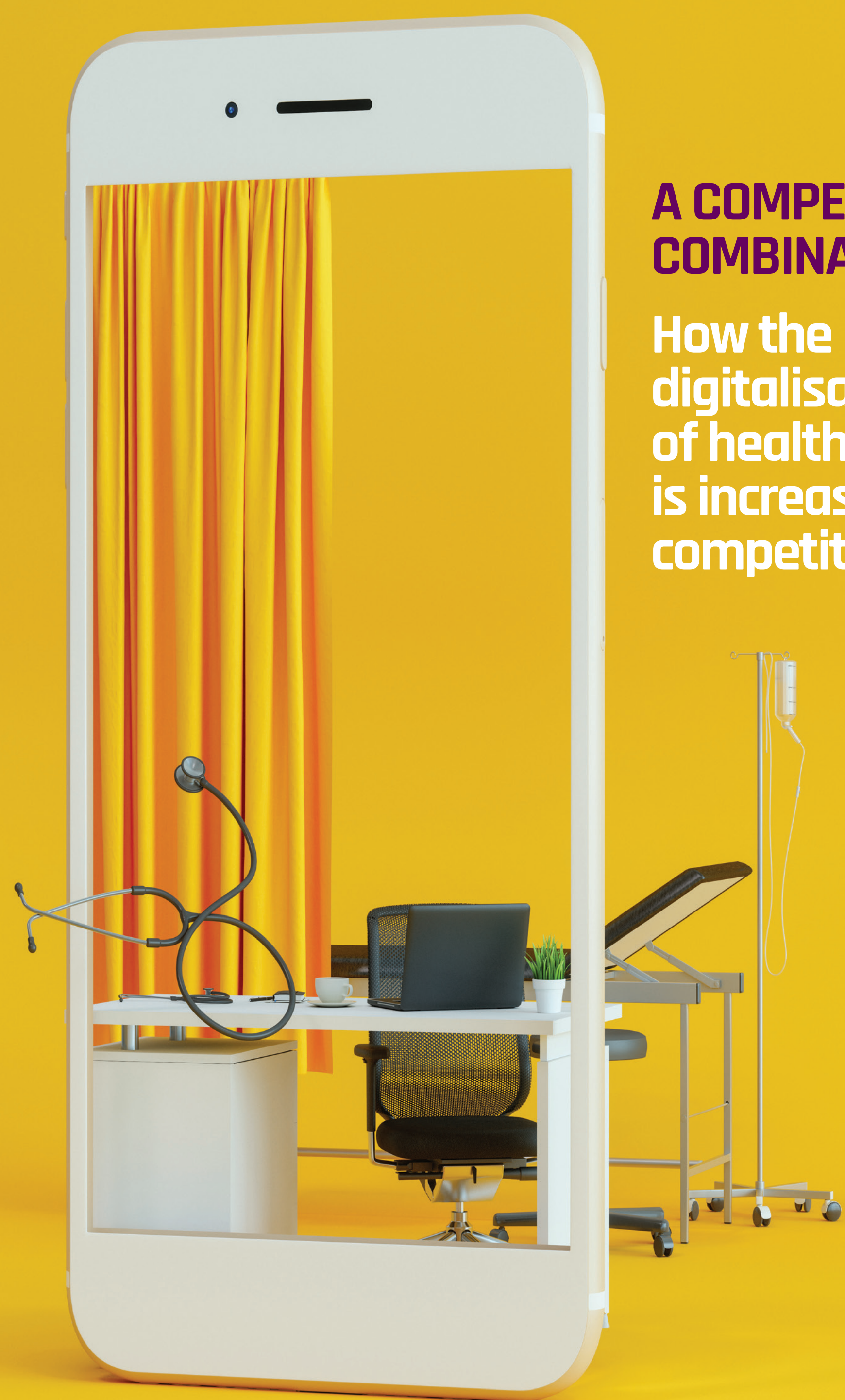

A COMPELLING COMBINATION

How the digitalisation of healthcare is increasing competition

KEYNOTE INTERVIEW

Innovative companies seize the day


Competition in healthcare is intense, but PE firms can succeed if they understand the post-covid ecosystem, say KPMG's Kristin Pothier and Glenn Mincey

Covid-19 has presented huge challenges for healthcare systems around the world over the past two years. However, it has also brought a new focus on investing in scientific breakthroughs that will not only fight the next pandemic but also help health systems adapt to the changing needs of society.

The result of this surge of investment in healthcare and life sciences has been an explosion in valuations and fierce competition for assets. In such a market, investors face a challenge in finding a niche that enables them to drive value creation. *Private Equity International* spoke to Kristin Pothier, KPMG's global lead in its healthcare and life sciences deal advisory practice, and Glenn Mincey, global and US leader of the firm's private equity practice, to find out more.

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Q What key trends are you seeing for PE firms in the healthcare and life sciences sector?

Kristin Pothier: We're truly living in a time of innovation right now. PE firms are getting more creative to match the market, with smaller deals that maximise value but also play to the ecosystem that we're dealing with.

The healthcare and life sciences ecosystem has changed completely. It's not just about the patient and the physician and medical system on one side with our product companies on the other. The ecosystems have converged, with medical centres working hand in hand with pharmaceutical companies bringing products to life, diagnostics companies shuttling patients to specific therapies, and research organisations working to find patients for pharma clinical trials worldwide.

We are also seeing a supply chain in distress and companies forming to try to ease that distress in this ecosystem. Investors are focusing on finding innovative ways to get inside this complex ecosystem to participate and to make it work better.

Glenn Mincey: Innovation is certainly characteristic of private equity, but it's also a response to the challenge of competing with strategic buyers in healthcare. Strategics often pay above what private equity firms will pay, which puts additional strain on valuations. Therefore, PE firms seek some sort of a value lever to support the investment. Innovation is one such lever to mitigate against the competitive landscape and other headwinds.

Q There have been a host of medical innovations resulting from covid-19. Can that progress be maintained after the pandemic?

GM: The response to the virus accelerated advances in science, especially with mRNA vaccines and antibody treatments. More broadly, the pandemic set new expectations for how quickly new innovations can go from lab to patient use. There's no question that the pandemic changed the baseline and it's very hard to retreat from it.

The pandemic challenged healthcare and life sciences in many ways, but that disruption compelled many lasting innovations, and many of the innovations we've seen in healthcare will be lasting ones. Covid hasn't just opened up opportunities to manage patient care through telehealth; it has forced the whole industry in the US to become more consumer-centric. Value-based care that elevates patient outcomes is the new normal.

KP: There's been a tremendous amount of investment flooding into the sector, especially on areas like testing, vaccines and therapeutic advances. The almost immediate returns from some of those investments during covid has incentivised corporates and investors to put more cash into scientific and clinical discovery.

It's a loop and it has really accelerated all the innovation in the space. All of our clients working in research and development are saying that their timelines have accelerated. They have a new normal as to how they do scientific discovery and how they move swiftly and effectively from R&D into translational research and then into the clinic.

Anybody that is working in healthcare right now is trying to understand how covid-related revenue is going to decrease and how they can refill their portfolios to make up for that revenue. Although that is virtually impossible – save another pandemic – investors in life sciences are looking with greater interest at companies that have introduced nimble innovation through covid and are now evaluating them for their follow-on products and services in the post-pandemic world.

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>
> GLENN MINCEY

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>
> KRISTIN POTHIER

Q What are the most important things a PE fund manager can do to ensure success in this environment?

KP: Covid has left us with a competitive landscape that's very different. PE firms are competing directly with corporates, and the race for the best assets is very intense. As such, success in this environment starts pre-diligence. The most successful PE firms that we work with are looking at their growth strategy for their portfolio companies and working to understand the market dynamics and a number of asset options, rather than getting their hearts set on just a few, way ahead of time.

Then, during diligence, PE firms must strike a balance not only between commercial innovation and commercial due diligence, but also financial due diligence. We find that some of the companies that are the most innovative do not have the strongest financial underpinnings. At the end of the day, a PE firm really needs to understand both of those dynamics and be able to do a full due diligence so that they know exactly what they're getting into.

Then, the real work starts post-deal during the integration and the subsequent growth plan. From a PE perspective, it's not enough to have a stable of horses. Firms need to make sure those horses are cared for, from retaining key management to ensuring day-one operations go smoothly, to continuing to support its growth with additional assets and organic investment. There's a lot more management of that occurring post-deal than we've seen in the past – and it's absolutely necessary.

Q Is it realistic for PE firms to compete with strategic buyers in the healthcare sector?

GM: The US healthcare system is plagued by fragmentation. There is a lot of bureaucracy and obvious inefficiencies, so there are plenty of gaps that create opportunities for private equity. But everyone's chasing the same deals and often strategics have a leg up – especially in acquiring more established assets that might already be integrated into local healthcare systems.

But if we look at healthtech and think about how tech can minimise costs simply by improving accessibility for patients, that is straight from the PE playbook of finding underperforming businesses, providing superior management, being nimble and unleashing innovation. Normally, people think about healthtech in the context of innovations in telemedicine, data and analytics, and artificial intelligence. But the possibilities extend into patient care, record management, payments and drug testing. Those technologies bring down costs and make the system more efficient. Investing in those types of businesses is what PE is really good at.

Q What is the outlook for PE firms investing in healthcare over the next year?

GM: Until recently, valuations were in the stratosphere – they were completely unreasonable. Now valuations have started to become more realistic and there's a realisation that this creates an opportunity for PE. I do think the healthcare and life sciences industry will be very bullish for the rest of the year – even in light of macroeconomic concerns around inflation and supply chain disruption.

KP: A lot of new companies are emerging as a result of the accelerated innovation and scientific discoveries that we've seen over the last couple of years – and many of these present excellent targets for PE firms. Because the valuations are coming down, more companies and more investors are able to play in the space and find more reasonably priced targets.

I also suspect a lot more PE firms are going to look at the market through a regional lens. We're seeing this with our clients today – they're seeking to understand the intricacies of whichever market they're focused on. A global approach doesn't work anymore in this environment, so we'll see more deals based around local systems – and on-the-ground diligence is going to be crucial for PE firms to make sure they know what they're getting into. ■

Q How do ESG considerations affect investment in healthcare?

GM: Engagement in healthcare and life sciences has historically been presented as an ESG metric in and of itself, but now it's gone beyond that. A driving goal in healthcare is accessible and equitable care for hard-to-reach and disadvantaged communities. That was really in the spotlight during the pandemic, when we saw acute demand for digital services to provide more accessible healthcare.

We also have an increasingly ageing population. People aged over 65 on average must spend three times more on healthcare per person than younger individuals. That spend is projected to more than double in the next 25 years. Even beyond the ageing population, a significant segment of the public still can't afford healthcare services, so we need to bridge that equity gap, both for the elderly and younger people of working age. There's a public health imperative there, as well as an investor opportunity.

KP: One of the things that we have recently seen in the industry, especially with pharmaceutical companies, is this focus on making clinical trials more diverse. There is now data tracking available that allows for underserved populations to be a part of those clinical trials, and a real focus on those underserved populations in general.

Because of the ESG wave and the scrutiny that pharmaceutical companies are under, they really need innovative companies to help them with clinical trials and recruiting, with data tracking to support their health equity mandate. Some smaller and innovative companies have cracked that nut as they have been able to find those underserved populations and track them appropriately, and provide tools to pharmaceutical companies. Those kinds of companies are therefore attractive targets for PE in the current environment.