HEALTHCARE INVESTMENT REPORT

A watershed moment for healthcare services

2021

DATA PROVIDED BY PitchBook

CohnReznick
ADVISORY • ASSURANCE • TAX

EXECUTIVE SUMMARY

2020 was a turbulent year for the healthcare services market. COVID-19 roiled the sector, and the pandemic's impact will be felt for years to come. From a revenue perspective, the pandemic had an overall negative impact on the sector, but that impact is only a small part of the story. Despite all the uncertainty caused by tidal changes in consumer demand and new regulations resulting from COVID-19, deal activity in U.S. healthcare services hit an all-time high last year. This report, done in conjunction with PitchBook Data, gives an in-depth look at the U.S. healthcare services market from private equity (PE) and M&A perspectives.

The pandemic brought a watershed moment for providers, who had to recalibrate their offerings if they hoped to treat their patients effectively. An obvious example is telehealth, which became a necessity for many providers operating under lockdowns and social distancing. Before COVID-19, telehealth was a promising technology that had the potential to revolutionize patient care, regardless of location. However, several surveys showed skepticism among patients and physicians alike. Many providers had developed plans to innovate digitally over time, but the pandemic forced those plans onto the fast track. According to a Centers for Disease Control and Prevention (CDC) study, telehealth usage rose 50% in the first three months of 2020 compared to the same period in 2019. The same study found a 154% year-over-year increase in telehealth visits in the last week of March. Both patients and physicians became more comfortable with the process. Similar changes were seen in meal delivery services and e-commerce models last year.

That sea change is emblematic of the changes ahead for the broader market. The healthcare services industry must grapple with some big questions such as how providers will position themselves for a post-COVID-19 world. The advent of telehealth will likely have a ripple effect on how patients are monitored remotely. For example, dominant telehealth provider Teladoc reported seeing remote visits surge from 4.1 million in 2019 to approximately 10.6 million in 2020, according to the medical magazine Stat.

Providers have seen those changes on the horizon and are using the M&A markets and private capital to expand their services to meet future demand. The pandemic will end eventually, but in the meantime, providers are focusing on adjustments to their business models and the ways they provide care to their patients. PE and M&A statistics give us tea leaves into how they plan to do that.

CONTENTS

THE STATE OF HEALTHCARE SERVICES

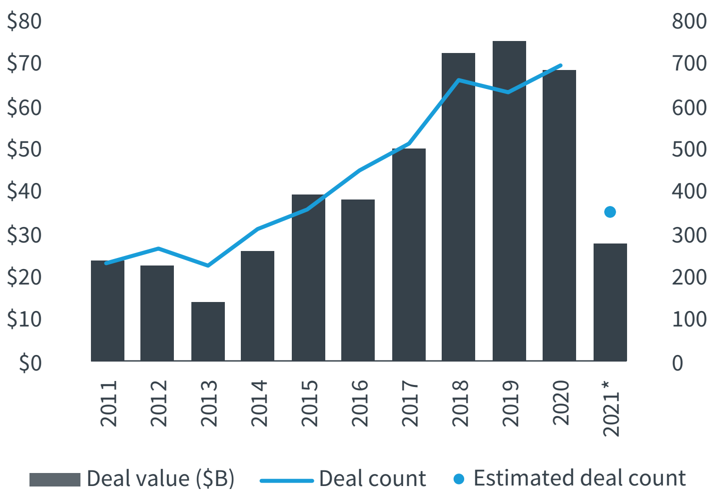
As mentioned, healthcare services PE deal activity reached an all-time high in 2020. Nearly 700 deals were struck last year, worth a combined $68.8 billion. Healthcare services PE deal volume increased by 10% year over year. For perspective, PE volume across all sectors increased by about 1% in 2020. The record PE deal volume in healthcare services was thanks to a late surge in the fourth quarter, which recorded 264 deals, easily the most ever seen in the sector in one quarter. The $29.6 billion invested was at least twice as much as a typical quarter in 2019 and earlier. Before COVID-19, the healthcare services market already enjoyed PE support, with deal volume more than doubling between 2013 and 2018. At the same time, combined value grew five-fold.

PE sentiment varied depending on the market. (Page 7 of this report highlights four subsectors within healthcare services.) Strong demand was seen in clinics & outpatient services, which saw record volume in 2020, as well as elder & disabled care services, which had a historically robust year. Within the clinical space, deal volume surged largely due to financial pressure among physician groups, while behavioral health providers saw an increase thanks to patient demand. The peripheral impact of instability in the workplace, home, and schools has been made visibly clear in demand for behavioral health services, including outpatient, inpatient, and residential. Accordingly, all three sites of care have seen heightened attention from investors, who are funneling resources into those sites to help minimize the impact.

In a related health area, there has been heightened interest in veterinarians. Several deals were struck last year, as Americans adopted pets in record numbers for companionship.

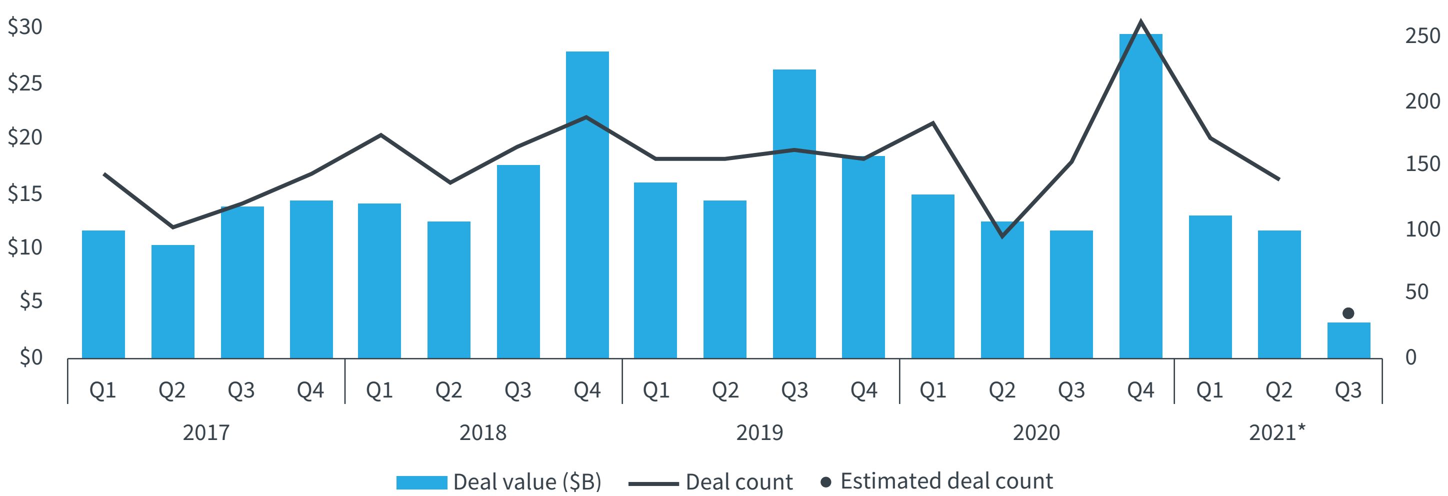
The record expansion in healthcare services marks long-term, structural changes in the market. The suddenness of the pandemic prompted providers and investors to look to the M&A market. Acquisitions were struck to fill short-term gaps in coverage, while other deals were made with an eye toward the future.

U.S. healthcare services PE deal activity



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

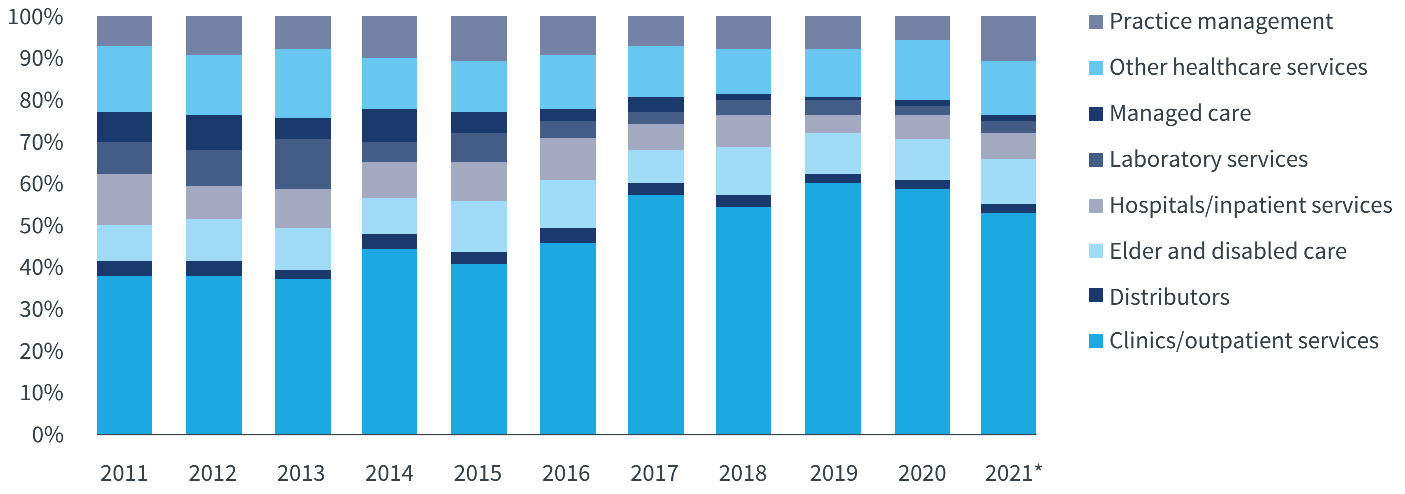
U.S. healthcare services PE deal activity by quarter



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

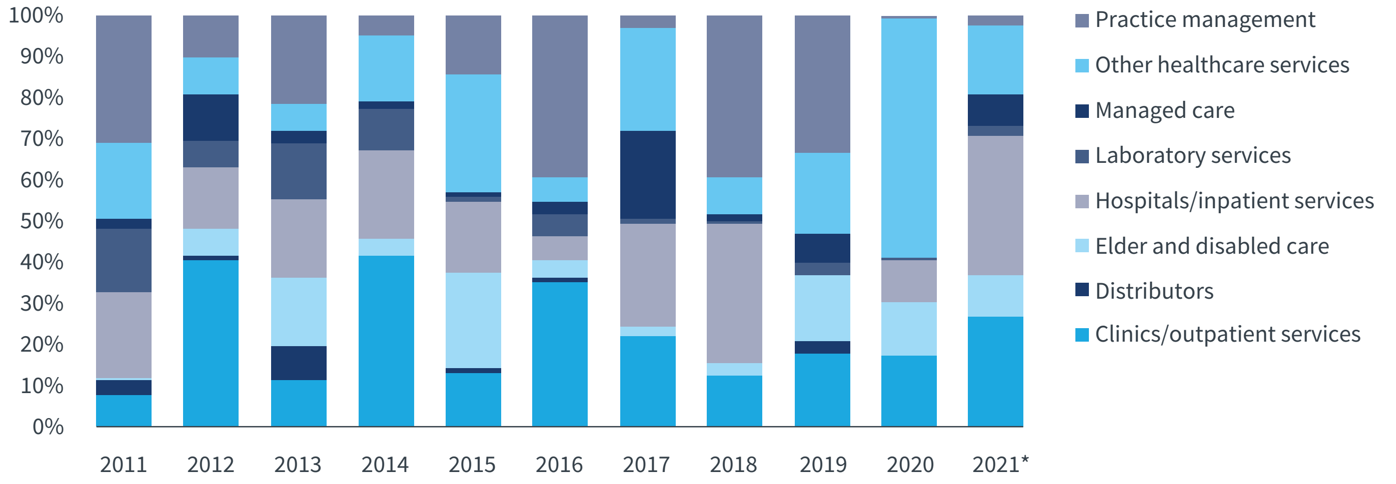
THE STATE OF HEALTHCARE SERVICES

U.S. healthcare services PE deal count by subsector



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

U.S. healthcare services PE deal value by subsector



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

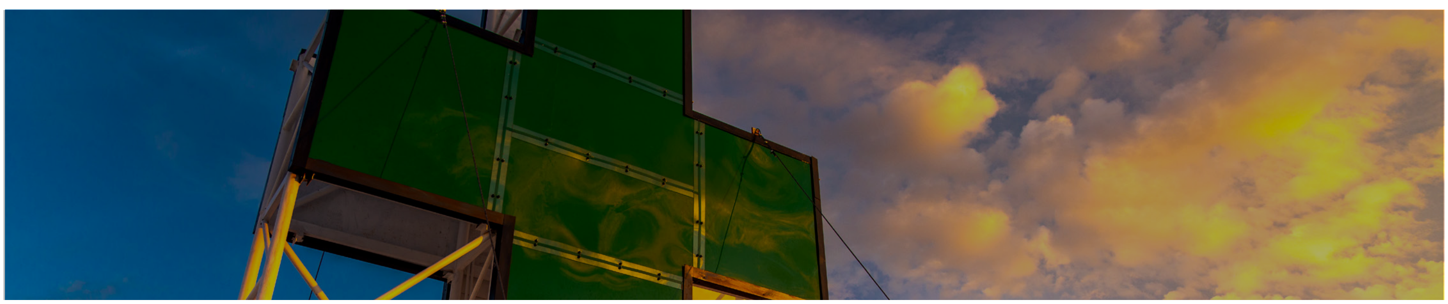
GRABBING MARKET SHARE

The pandemic's onset provided an opportunity for providers to reshape themselves. While some of those changes were made organically, quicker options were presented in the M&A market. By deal count, healthcare services M&A set a new high in 2020, hitting 994 transactions. Despite the uncertainty, that figure represented a 12% increase over a more tranquil 2019. Combined M&A value last year was $110.7 billion, the second highest on record, and 2021 is likely to be another strong year.

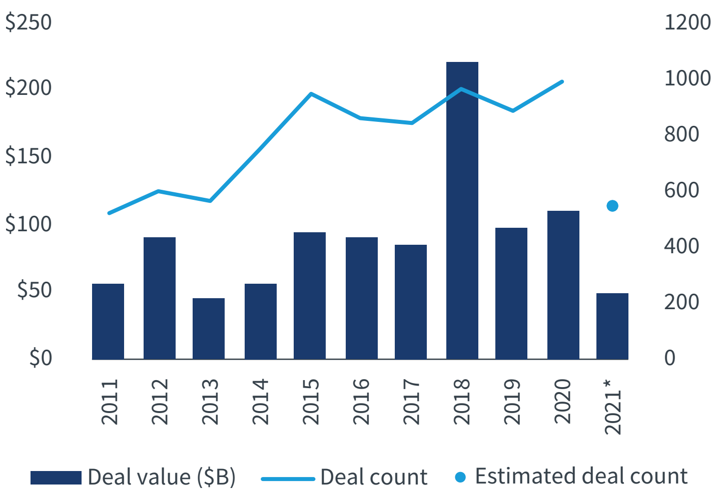
Healthcare services was already a fragmented market, which had been the primary driver of dealmaking for the past decade. COVID-19 accelerated that trend. In years past, strategic buyers and PE firms mostly battled over EBITDA multiples and synergy assumptions in a high-priced environment. That dynamic changed in 2020 – especially for strategics. Many providers were keen to acquire new capabilities to meet consumer demand. Others, however, were forced to recalibrate their offerings and divest certain business lines. Strategic M&A now largely depends on what the strategics are facing in terms of revenue, customer demand, and shifts in the broader landscape.

PE, on the other hand, is flush with cash and eager to spend. Investors expanded their portfolio companies in a big way in 2020, leading to more than 500 add-on transactions last year. Add-ons accounted for 72% of all healthcare services buyouts in 2020, reflecting the opportunity investors had to grow their platforms. Almost 200 add-on transactions closed in Q4 2020 alone, most of which were announced months beforehand. Dermatology, gastroenterology, and behavioral health outpatient clinics were popular targets. At the same time, PE firms benefited from strong buyside demand for their current portfolio companies. In each of the three quarters from Q4 2020 to Q2 2021, at least $10 billion worth of exits were finalized, including a record $22.1 billion worth of sales in Q2 2021. Dating back to 2010, only three other quarters recorded that much exit value, largely due to one abnormally large exit in each quarter.

We expect to see more market consolidation over the near-term. The M&A landscape is now a critical venue in which to pursue dynamic change. A new obstacle is how to value those transactions with so much change happening at once.

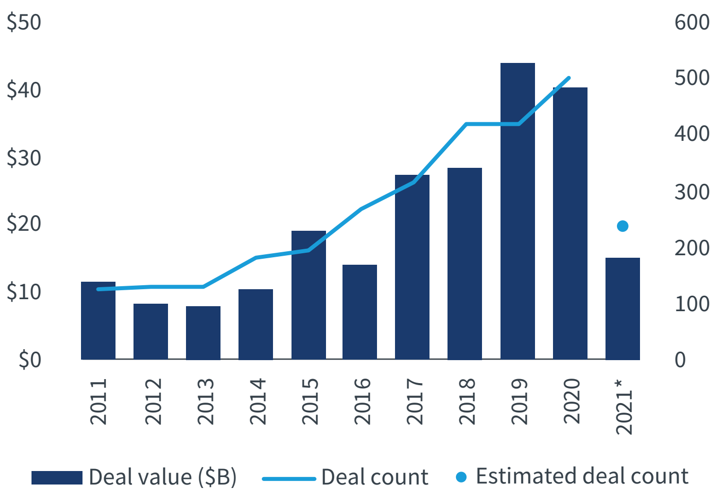


U.S. healthcare services M&A activity



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

U.S. healthcare services PE add-on activity



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

COVID-19'S IMPACT ON VALUATIONS

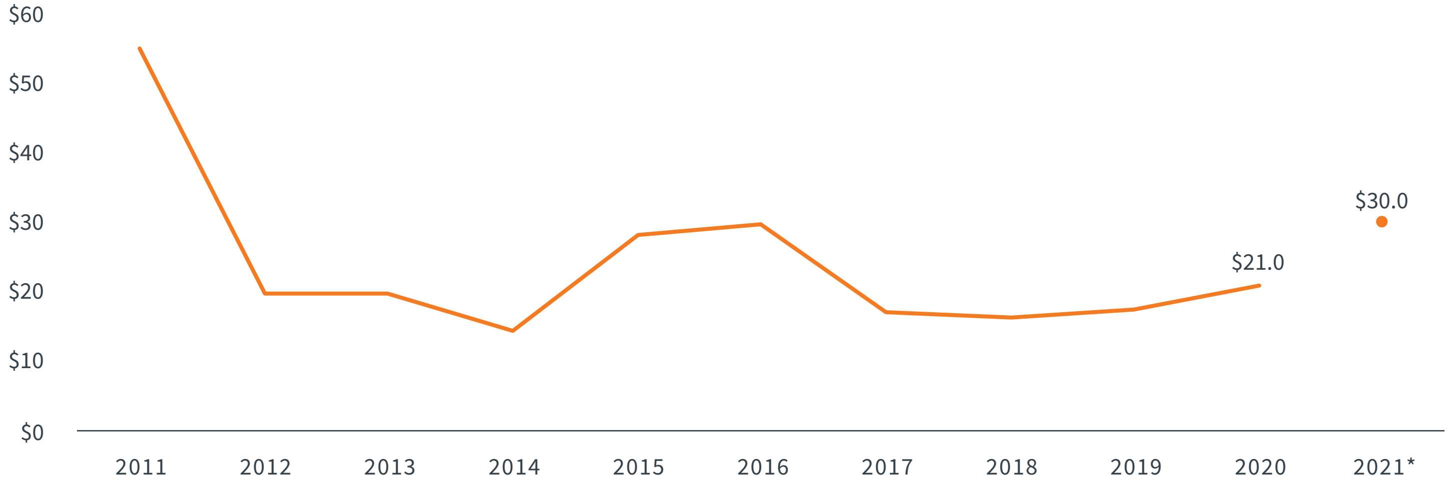
2020 was a difficult year in which to accurately price healthcare providers because COVID-19 had an adverse impact on revenues in the spring and early summer. Healthcare service providers, through no fault of their own, saw profits erode for several months, which caused a schism between buyer and seller expectations throughout the year. The deals that did happen created a selection bias in the data – valuations were highest for providers with resilient operations behind them and strong outlooks post-COVID-19. Providers that were adversely affected by the pandemic had to be taken off the market. As a result, the numbers below don't necessarily reflect changes in demand, and service and payer mix.

The average M&A transaction was valued at $376.3 million in 2020, nearly double the 2019 average of $193 million. The median also went up, from $17.8 million in 2019 to $21.0 million in 2020. The same dynamic is in play this year: The average price tag for healthcare services M&A was $568.2 million through late July, while the median stood at $30.0 million. In the background, hundreds of providers are adjusting their business models to compete effectively in the new market. As companies get back on their feet and return to market, valuation metrics will start to become more reasonable.

Valuations are a helpful prism through which to view service providers. For example, telehealth-driven revenues are subject to change going forward. In response to COVID-19, regulators expanded Medicare and Medicaid reimbursements to include online appointments; however, so far the change has been temporary, so providers have reason to question whether that regulatory adjustment will endure long-term – and the answer to that question will impact healthcare provider valuations going forward.

From an investor standpoint, the valuation question also hinges on the ability of a provider to adequately offer those services online or over the phone.

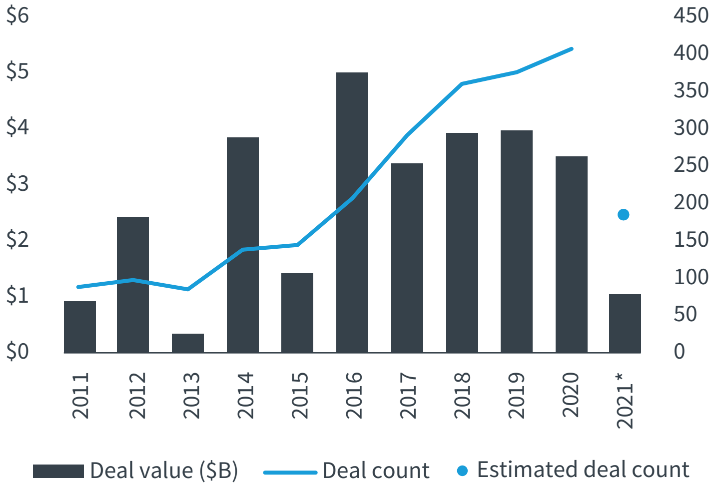
Median U.S. healthcare services M&A post-money valuation ($M)



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

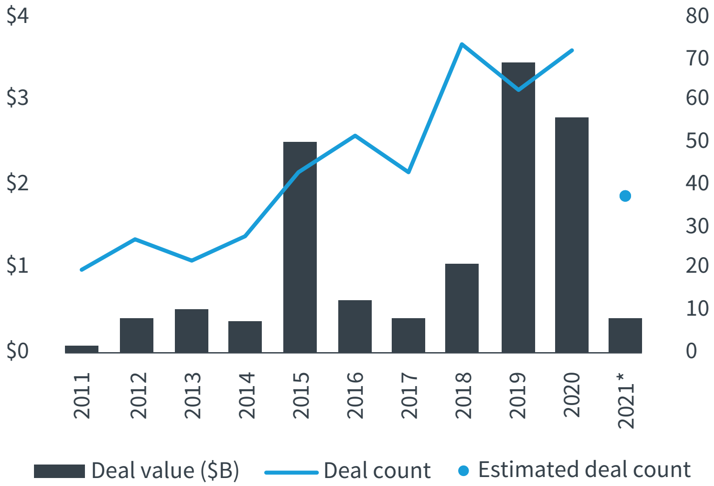
WHERE ARE INVESTORS LOOKING?

U.S. clinics & outpatient services PE deal activity



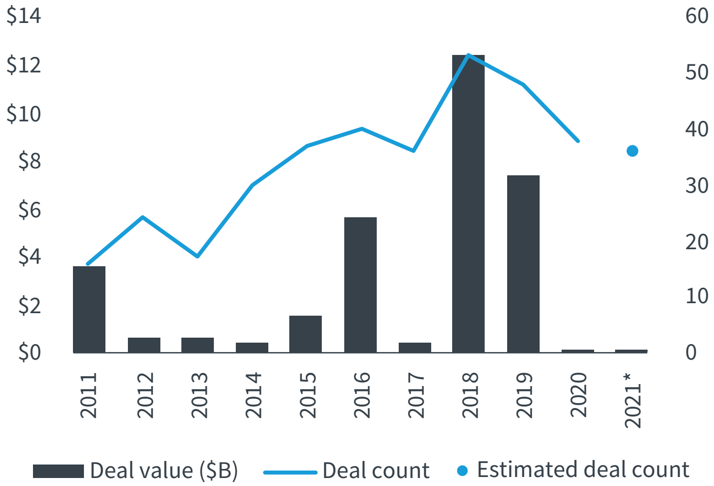
Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

U.S. elder & disabled care PE deal activity



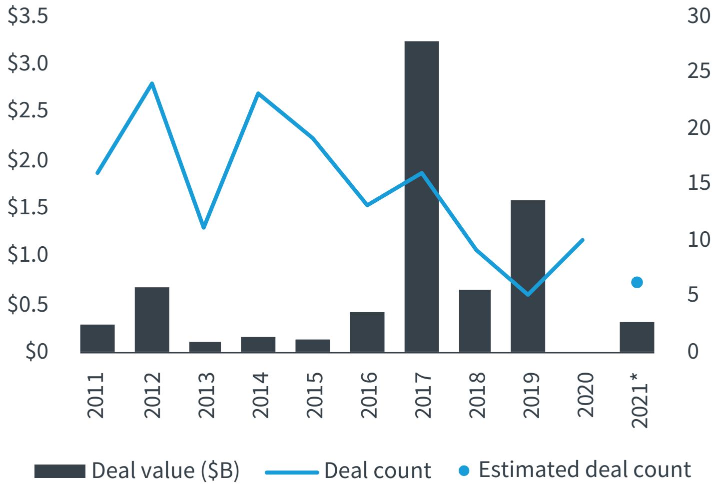
Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

U.S. healthcare practice management PE deal activity



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

U.S. managed care PE deal activity



Source: PitchBook | **Geography:** U.S.
*As of July 29, 2021

COVID-19 tests healthcare's resilience – A Q&A with CohnReznick

Please share your thoughts on the current healthcare services market. (Specifically, what has changed for the sector compared to pre-COVID-19?)

Caroline Znaniec: Thinking about it from the provider perspective, COVID-19 has brought attention to where healthcare financial operations were weak. When you take relief funding and the grants out of the picture, the surviving providers are those that prior to COVID-19 had better cost discipline, liquidity, larger geographic presence, and diversification of service offerings. The pandemic is also changing how providers are delivering care and how payment models are adapting. Both of those changes are forcing providers to not look at their situations as "business as usual." The more successful provider will be one that is nimble and strategic.

More broadly, there's this perception that the increase in healthcare investing by private equity (PE) is lowering the quality of care. That's not how I see it. I don't think providers intentionally give poor care. Many just do a bad job of demonstrating the quality of care they provide. Providers are judged more now than ever on the metrics and outcomes they report. Coming out of COVID-19, there is going to be more focus on the quality-of-care discussion, and providers that can demonstrate good results around the value of quality of care will be rewarded.

Claudine Cohen: It's also worth noting that COVID-19 caused an increase in the cost to do business, including the need to invest in technology, which for many providers is not feasible. Many management teams that survived last year decided to put their companies up for sale, which is helping to fuel broader consolidation trends.

In the same vein, how has PE interest in the sector changed compared to pre-COVID-19?

Cohen: At the end of the day, what COVID-19 revealed was how resilient the sector turned out to be. Businesses did far better than anyone expected, and PE interest increased as a result. Valuations are climbing, with some small physician groups with $3 million of EBITDA trading at eight or nine times in the current market. It's unheard of.

Let's dive further into that. What has been COVID-19's impact on healthcare services valuations?

Cohen: There is still absolute demand in the market, with an abundance of capital and a shortage of great assets. That's one reason why smaller providers are trading at such high levels. The buy-and-build strategy is still out there, which comes with attractive arbitrage opportunities – investors can blend down the multiples paid for their platforms. I don't think the focus of our clients has changed much due to COVID-19, aside from more focus on digital health. There isn't a lot of history around valuing digital health companies. The digital health companies that are performing well are trading at very high valuations.

Claudine Cohen

Managing Principal, Transactions & Turnaround Advisory, CohnReznick LLP

Claudine Cohen is a managing principal and leader of CohnReznick's Transactions & Turnaround Advisory practice. She oversees an integrated team of transaction, valuation, restructuring, project finance, and dispute resolution professionals serving clients throughout the lifecycles of their businesses. Her experience includes working with hospitals, physician practices, ambulatory and outpatient clinics, healthcare service businesses, laboratories, CROs, and other healthcare organizations. Claudine was named to Mergers and Acquisitions' 2019 list of the most influential women in mid-market M&A, and Crain's NY 2018 most notable women in consulting.

Caroline Znaniec

Managing Director, Healthcare Industry Practice, CohnReznick LLP

Caroline Znaniec is managing director and leader of CohnReznick's healthcare industry practice. She has over 25 years of healthcare industry and consulting experience with expertise in healthcare strategy and revenue cycle transformation. Caroline works with various healthcare provider organizations including hospitals, health systems, skilled nursing facilities, home health, physician groups and clinics, free-standing providers, payers, private equity groups, and investors of healthcare providers. Caroline is a recognized industry speaker and author in the areas of healthcare strategy and revenue cycle transformation.

COVID-19 tests healthcare's resilience – A Q&A with CohnReznick

Znaniec: To Claudine's point, say a handful of mom-and-pop providers are being rolled up into a new platform. Money has to be invested in their digital capabilities. Many smaller providers haven't invested their own money into these large technology platforms, but there's an opportunity to do that once they've been consolidated into something bigger. And as providers improve their digital presence, they can further reduce other costs attributed to inefficiencies that come with the lack of technology.

How does telehealth capability change a company's potential valuation?

Cohen: The bankers whom I talk to have indicated that those multiples are much higher than what traditional providers are fetching. Those businesses can be marketed as tech-enabled services. If you can successfully merge technology into your current model, you'll likely see more interest from potential buyers. Bankers are taking advantage of labels like "healthtech" and "medtech" in terms of marketing, not only to PE or strategic buyers but also to special purpose acquisition companies (SPACs).

Znaniec: And as telehealth grows and patients become more comfortable with it, remote monitoring will also become more important. When doctors need to talk about test results – or patients are hooked up to heart monitors and doctors need to discuss something in real time – those capabilities will be very important going forward. That's what consumers will be asking about and basing their decisions on.

Did COVID-19 prompt some PE investors to get into healthcare services – perhaps for the first time?

Cohen: That was definitely the case with home health and hospice. Home health isn't the most attractive business model, in terms of managing healthcare aides and the reimbursement questions in the sector. With the ongoing pandemic, we're seeing so much activity from investors. Many patients don't want to be in a hospital right now, and current technology can facilitate that.

Znaniec: I've had conversations with investors who weren't really in healthcare before, but they're gravitating toward it now. We sometimes talk about the questions investors should be asking – I get worried about the questions investors aren't asking. Healthcare is one of the most regulated industries in the country, and when you think about the potential audits coming out of COVID-19, you get the sense that many people don't appreciate the importance of the results and how that can change an investor's circumstances. There are lots of nuances involved, and you can't jump into it simply because it's growing.

Read an extended version of this Q&A at [CohnReznick.com.](CohnReznick.com)

About CohnReznick

As a leading advisory, assurance, and tax firm, CohnReznick helps forward-thinking organizations achieve their vision by optimizing performance, maximizing value, and managing risk. Clients benefit from the right team with the right capabilities; proven processes customized to their individual needs; and leaders with vital industry knowledge and relationships. Headquartered in New York, NY, with offices nationwide, the firm serves organizations around the world through its global subsidiaries and membership in Nexia International. For more information, visit www.cohnreznick.com

A member of Nexia International

CohnReznick is an independent member of Nexia International