Finance

10 healthcare innovation investment trends to watch out for

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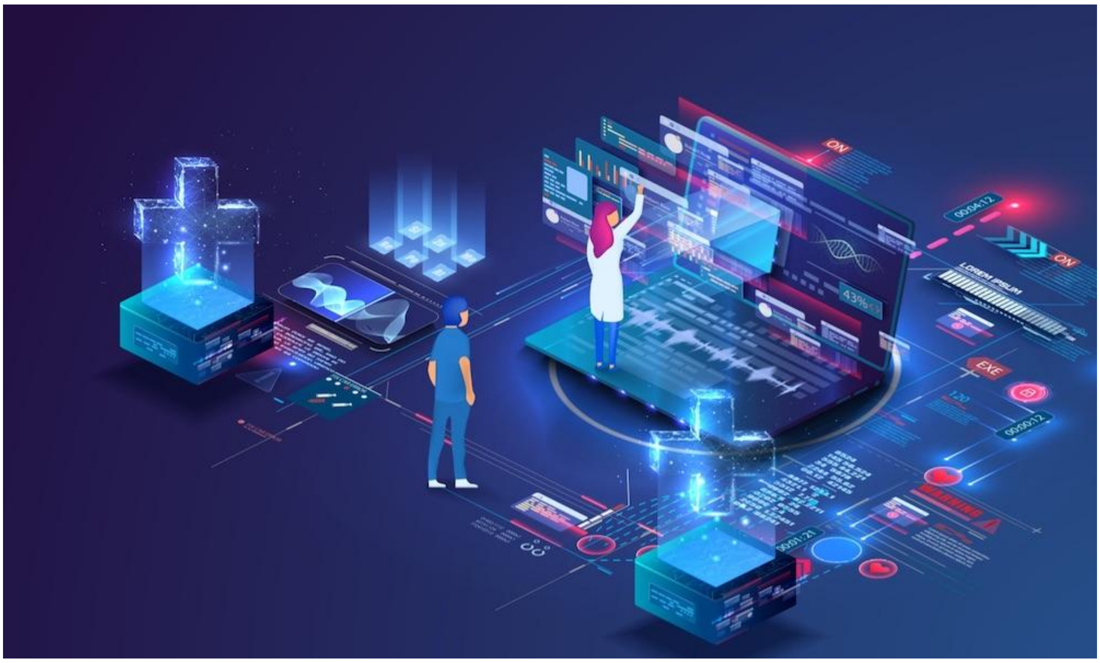

As the world enters a phase of the global pandemic marked by an increasing rate of vaccinations, investors are looking for global (particularly, European) healthcare market opportunities.

With the emergence of certain investment trends, this article takes a look at what we have identified as the top 10, which have the potential to drive and shape the healthcare market over the short- and medium-term.

1) Expect to see more "take private" transactions

There is an increasing number of "take private" transactions being launched, especially in the United Kingdom. Since the start of 2021, market experts have seen nearly £35bn of bids launched in the United Kingdom alone. This trend to "take private" is arguably because public markets are not pricing assets correctly. When compared to equivalent deals in the private arena, assets are relatively underpriced.

2) More infrastructure and sovereign wealth funds (SWFs) investing

Infrastructure and SWFs are becoming increasingly active. These funds are now set up like sector teams at private equity funds (sometimes hiring from the same talent pool), so they provide a better insight into the market than was previously the case. Many infrastructure funds have also expanded their core segments beyond the traditional areas for infrastructure investment and see healthcare as “infrastructure plus.” As a result, more infrastructure funds closing deals in the healthcare space is expected, adding to an already highly competitive sector and helping to sustain higher prices for assets in this area.

3) Continued high prices in general with the highest prices being paid for those assets with the greatest growth potential

Though some pundits argue that investors are paying inflated prices for healthcare assets, others believe there is good price discipline and a sound rationale behind the current pricing. If you look carefully, you will see that there is a big differential between the various healthcare segments.

Although healthcare earnings before interest, taxes, depreciation and amortisation (EBITDA) multiples are averaging 14 to 17 times, market experts are seeing even higher multiples being paid in the healthcare tech area with EBITDA multiples of 20 times plus not uncommon.

At the other end of the scale, healthcare assets in the care home sector are currently trading around the eight times EBITDA multiple. It is important for investors to understand the growth trajectory of those companies with the highest multiples and the structural shifts in global healthcare that are happening as a result of the pandemic.

Understanding the trends makes pricing easier to understand—especially in cases where assets will be held long-term. The fact that there are some assets that are not trading because seller price expectations are too high underscores the case that investors continue to be disciplined and are only prepared to splash out where they can see the growth and a defensible competitive position.

4) The market will continue to be a seller’s market

With the increasing number of entrants into the healthcare market highlighted above and each investor looking for the next big growth opportunity, market experts are also seeing an increasing number of preemptive bids for those assets with sellers driving aggressive deal terms.

Preemptive buyers are likely to have been tracking an asset for some considerable time, which means they already understand and know the management ream as well as the growth trajectory of the business and its potential. Accordingly, a well-educated buyer can take an informed view on deal risks.

Conversely, some processes where there are fewer participants are longer as buy-side parties conduct more substantive due diligence and look closely at the business plan to see if the target is sustainable and resilient.

Against the background of COVID-19, investors are now asking, “How does this business model work?” and “If another hit comes, can it cope or be flexible?” In many cases, sellers will still decline to sell if their price expectations are not met and look to extract value in other ways, including through financing. They may also choose to revisit their own business plans and see how they can drive further growth and value before coming to the market again.

5) There is new awareness of healthcare vulnerabilities and more government and private investment is being made in healthcare systems

The needs of a global pandemic informed a reevaluation by governments about what needs to be done to set up a next-level healthcare system—including digitalization, supply chains for pharmaceuticals and supplies and telemedicine—and in the process, new investment opportunities have emerged in these and other areas. Governments appear to have recognised that they need to work with the private sector to deliver on this goal and improve healthcare for their populations and solve vulnerabilities that COVID-19 revealed. This presents real opportunities for investors and should further increase the size of the healthcare investment market.

6) New countries may replicate successful franchise models

Market experts anticipate more opportunities to replicate some of the franchise and chain models that have become popular in the United Kingdom and other parts of Europe where the model is not yet established, such as Germany and (to a certain extent) France. This includes businesses in the dental, pharmacy, ophthalmology, wellness, veterinary and similar chain sectors.

7) Compliance and good environmental, social and governance (ESG) is earning a premium

Targets with a robust compliance system in place are earning premiums of up to 10 per cent, particularly those that can show they flagged compliance issues in the past and rectified them. Although compliance has sometimes been seen as a pure cost centre for investors, it is now being looked upon as a positive value add.

Having a robust compliance process in place assists sellers in achieving a smoother exit as fewer issues arise in this area and, therefore, does not give buy- side investors the opportunity to discount their bid price. Having good governance in place also helps drive valuations. Investors are demanding that the businesses they invest in have robust ESG policies because ESG factors are a key criterion in their investment decision-making.

8) The shift from stationary to ambulatory continues

There is a trend apart from stationary solutions that are more ambulatory, which is creating investment opportunities for businesses involved in every aspect of making that shift happen. For example, this would cover telephonic- and internet-based consultations, telemedicine, self-testing and the use of apps to gather data. This can lead to significant time and cost savings for both the consumer and the provider.

9) There is new momentum behind globalisation

Healthcare was already globalising but the pandemic served as an accelerant for this trend. The virtual trend allowed a realisation of the value and appeal of care in the home and has rapidly become more consumerised. At the same time, an entirely new world of consumer healthcare products began to gain real traction, such as wearable glucose monitors. People around the world are using the same apps and the same data.

Both market shifts have resulted in patients accessing healthcare in new ways, with far more similarities worldwide than differences. As this new reality becomes the foundation from which healthcare solutions are developed, businesses are likely to expand faster geographically than they did historically.

10) Public-private partnerships present meaningful opportunities

There has always been tension between the public sector provision of healthcare and the private sector's involvement in it. Now, there's a nearly universal commitment, effort and focus to make healthcare better, and there is no argument that the private sector has a significant part to play.

This is partly based on the government's limited liquidity (after all the pandemic schemes that have been put in place to keep their economies). With this backdrop, there has been no better time for the public and private sectors to work together to tackle the big health issues arising out of the pandemic, (*e.g.*, the backlog of elective surgeries).

The analysis presented in this article stems from McDermott Will & Emery's HPE Europe 2021 virtual conference and key sessions examining the current challenges in healthcare investment and private equity.

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