Global Healthcare Industry

M&A and Capital Market Landscape Q1 2022 Review

Corporate and Investment Banking Practice

Global Healthcare Market – 2022

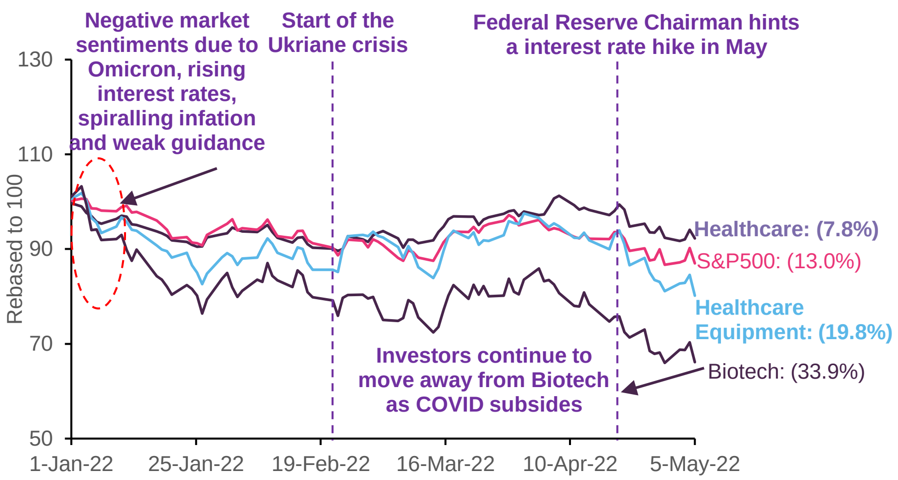
The start of 2022 has been in stark contrast to the economic buoyancy witnessed last year. Even though it has been almost two years since the outbreak of COVID-19, the pandemic is still proving to be a challenge for governments across the globe. Though mass vaccination drives in advanced economies instilled positive market sentiments, the advent of geopolitical tensions and the subsequent volatility have dampened sentiments. Additionally, lockdowns in China are expected to lead to new bottlenecks in the global supply chain. The possible emergence of a new COVID-19 variant continues to highlight the need for an effective global health strategy that reduces future risks.

The global economic growth is likely to slow down from 6.1% in 2021 to 3.6% in 2022 (IMF), driven primarily by the Ukraine crisis and subsequent inflationary and supply chain pressures. Overall, economic risks have increased significantly, making policy tradeoffs even more challenging.

The resiliency of the healthcare industry has been on display throughout the pandemic with investors continuing to view the sector in terms of its historical position as a 'go-to' market, given its proven ability to be structurally stable and offer impressive prospects across the economic cycle. The healthcare sector has outperformed the broader market primarily due to 'flight to safety' in the midst of growing market volatility. Globally, investors continue to seek out pockets of high growth across geographies and sub-sectors for their 'cautious' capital.

Within the healthcare industry, healthcare equipment's relative outperformance (refer to the graph below) was driven by the urgent need for innovative care delivery in new or alternative care settings, which was offset by the delayed recovery of demand especially for elective procedures. On the other hand, Biotech heavily underperformed Q1'22 primarily due to shifting of focus towards cyclicals, reduction of Omicron cases and negative sentiments arising as of result of greater regulatory clampdown on transformative deals, and drug pricing by the current administration.

US Market Performance (YTD 2022)



Source: S&P Dow Jones US market Indices; as of May 05, 2022

The healthcare equipment sector's performance declined on the back of lower COVID-19 testing, staffing shortages and supply-chain issues exemplified by the Ukraine crisis partially offset by growing core business.

In 2022, the broader healthcare sector is projected to be in the limelight due to increased demand for innovative therapies and possibilities of another Omicron variant, which will keep global markets on edge.

We continue to view the healthcare industry as a key growth engine for the overall market in the coming days driven by a paradigm shift in investors' ideology of viewing the sector as more than just a 'defensive' strategy

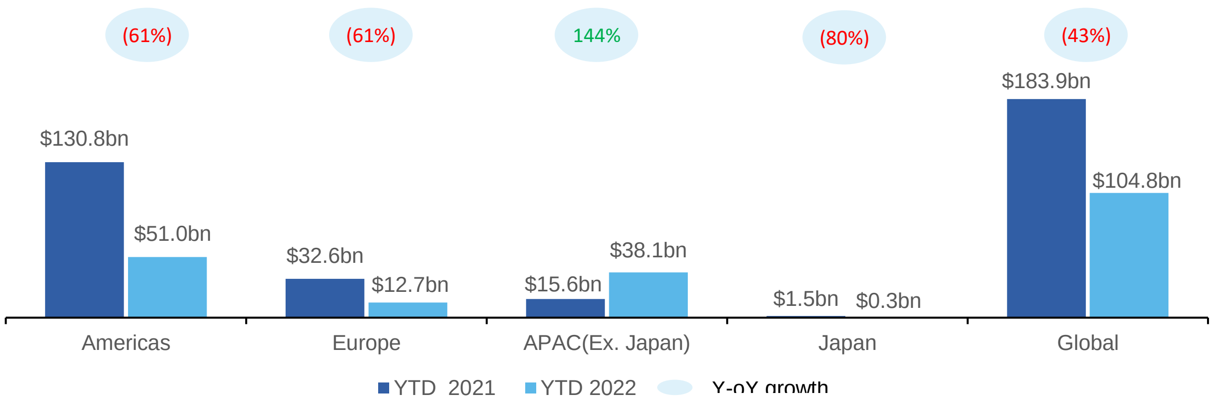
Global Healthcare M&A 2022: Recalibration of Expectations

M&A in the global healthcare industry was muted in 2022, compared with a blockbuster 2021. Investors were primarily forced to hold off on deal making as a result of the uncertainty regarding the global growth outlook.

The industry witnessed limited deal closures and is yet to see the conclusion of some 'big ticket' deals. The volume of deals withdrawn till date is comparable to that at the onset of the pandemic. As a result, dealmakers are having to amend their strategies in order to bridge the valuation gaps. They are conducting deeper analysis of the targets thereby extending duration of negotiations and due diligence. The ability to recognize, negotiate and realize value from increasingly complex partnerships and alternative collaboration models has become a key competitive differentiator. Considering these developments, we expect the following themes to impact M&A sentiments in 2022:

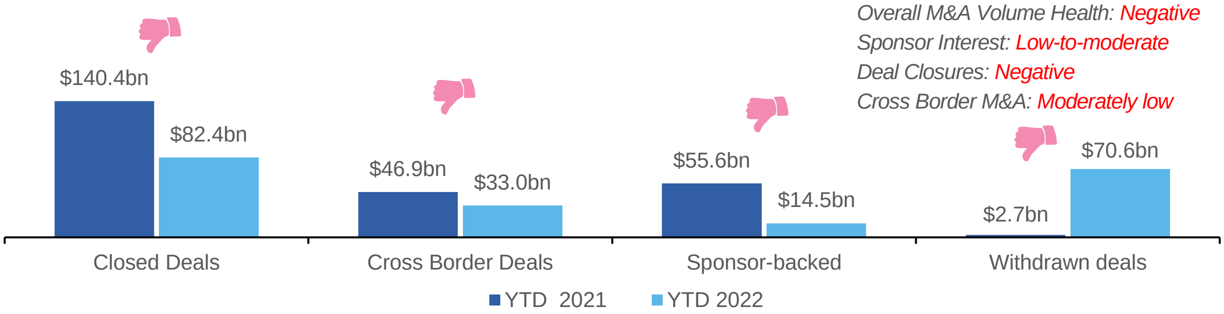
- Uncertain geopolitical environment and higher interest cycle puts pressure on justifying synergies and ROIs
- Sponsors turning cautious and revising their expectations to factor in the changing deal making landscape
- Focus on ramping up digital capabilities
- Portfolio realingment among the strategics to divest non-core or under performing assets
- Rapid paradigm shift towards utilizing data and actionable insights to implement person-centric network strategies across sub-sectors

Global Healthcare Regional M&A YTD 2022 (USD bn)



Source: Refinitiv; deals as of May 05, 2022

Global Healthcare M&A Volume Analysis

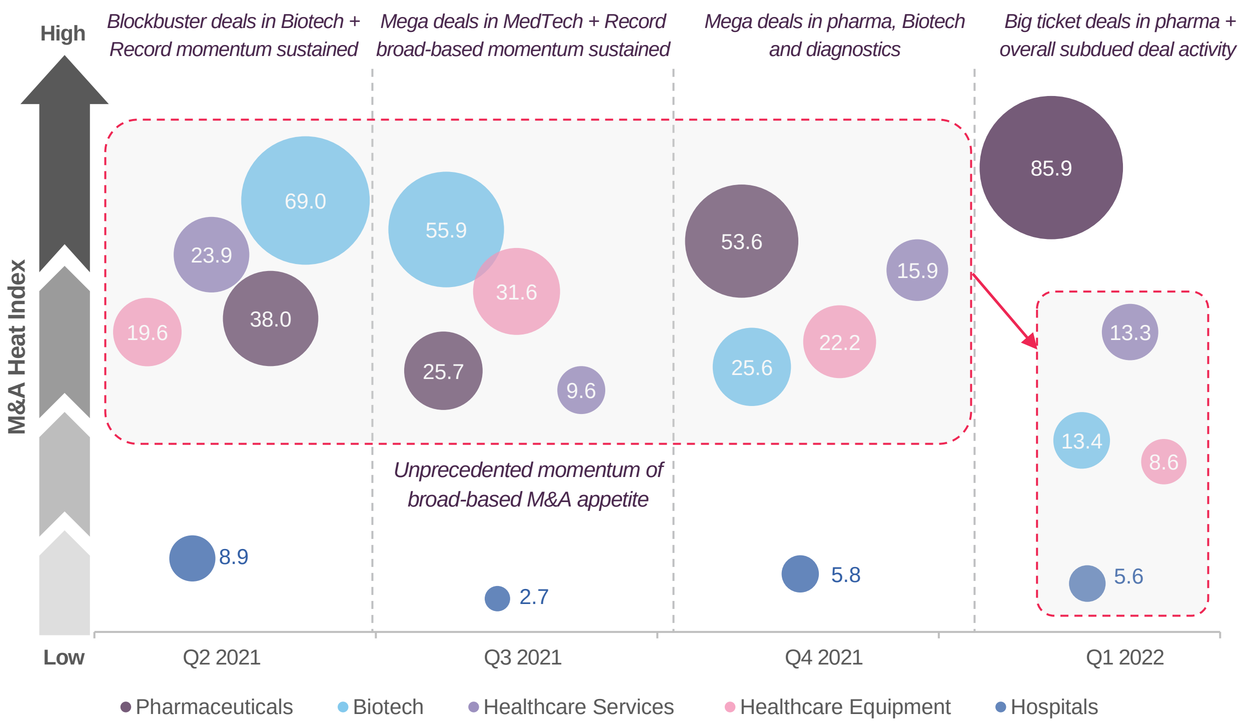


Overall M&A Volume Health: Negative
Sponsor Interest: Low-to-moderate
Deal Closures: Negative
Cross Border M&A: Moderately low

The deal activity turned cautious in 2022 driven by business disruptions from the Omicron wave early on, rising interest rates, Ukraine crisis and concerns over inflationary pressure persisting throughout the year

A deep dive into the key sub-sectors reveal just how broad-based the decline in deal activity has been. It was only the Pharma sector that continued its blockbuster momentum, driven by growing evidence on 'efficacy' and the urgent need to streamline and replenish pipelines with innovative therapies. Digital Health continues to be a M&A hotspot, as COVID-19 has catalyzed the rapid regulatory and reimbursement shifts favoring the sector. The hospital and medical equipment sectors saw a decline in deal activity driven by low volumes of elective procedures and constrictions in the global supply chain due to resurgence of COVID-19.

Global Healthcare Sub-Sector M&A Heat Index (USD bn)



Source: Refinitiv as of March 31, 2022; M&A Heat Index is based on the equal weightage of average deal size and number of deals during each quarter; bubbles represent overall deal activity in USD billion during the respective quarter

Key 'Big ticket' M&A Deals in 2022 (USD mn)

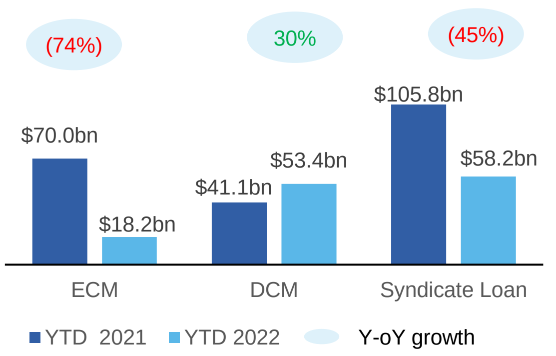
Announ. date	Acquirer	Target	Deal value	Advisors
21-Apr-22	Clayton, Dubilier & Rice	KAH Hospice (60% stake)	~2,800	Barclays, Goldman Sachs, Deutsche Bank, UBS
19-Apr-22	Groupe Bruxelles Lambert	Affidea	~1,700	Goldman Sachs, Jefferies, Citigroup, Ernst & Young
18-Apr-22	ArchiMed Group	Natus Medical	~1,200	Stifel, Nicolaus, Jefferies
13-Apr-22	GSK	Sierra Oncology	~1,900	Lazard, PJT Partners
05-Apr-22	Strong Point Capital	Tivity Health	~2,000	Lazard, Truist Securities
29-Mar-22	UnitedHealth Group	LHC Group	~5,400	Jefferies, SVB Securities
01-Mar-22	AbbVie	Syndesi therapeutics	~1,000	Lazard
25-Feb-22	Biohaven	Channel Biosciences	~1,240	RBC Capital
19-Jan-22	UCB	Zogenix	~1,900	SVB Securities, BofA, Lazard, Barclays
18-Jan-22	Social Capital Suvretta Holdings Corp. III	ProKidney	~2,640	Citigroup, Evercore
10-Jan-22	Owens & Minor	Apria	~1,600	Citigroup, Goldman Sachs, Evercore, JPMorgan
10-Jan-22	R1 RCM	Cloudmed	~4,100	Goldman Sachs, Barclays, JPMorgan, Centerview
06-Jan-22	Stryker	Vocera	~3,090	Evercore
05-Jan-22	Thermo Fsicher	PeproTech	~1,850	JPMorgan

Source: Company filings, FactSet as of May 05, 2022

Healthcare Funding– Geopolitics and Volatility Curbing Demand

The financial equity and debt capital markets (ECM and DCM) witnessed contrasting demand this year. The DCM witnessed borrowers rushing to refinance and extend debt maturities before the potential rate hikes later in the year with focus on building 'fortress balance sheets'. Lenders, on the other hand, have focused on generating higher yields, with refinancing emerging as the major avenue for the deployment of their 'eager' capital. Though DCM expectedly witnessed an uptick in Q1'22, the Syndicated Loans market mostly came to a halt after the Russia-Ukraine conflict began. The recent scrutiny of SPAC IPOs and its redemption pressure plus lack of investors' demand for traditional IPOs have stalled activities in the ECM. The revival of market sentiments and inflationary pressure and rising interest rates are expected to be the key factors determining the capital market activity for the rest of the year.

Global Healthcare Capital Markets Activity



Source: Refinitiv; deals as of May 05, 2022; values are in USD

- In the ECM, IPOs fell back to the pre-pandemic levels amid high market volatility, weak aftermarket performance and lack of investor demand
- DCM issuances increased as companies raced to the bond markets, even during Ukraine crisis, as they tried to lock-in the low interest rates before the potential rate hikes globally
- Issuances of syndicated loans declined primarily due to geo-political crisis, with investors pausing to review their portfolios and the related primary and secondary risks

ECM should witness a gradual recovery during the year driven by the availability of innovative assets, whereas DCM should normalize further depending upon the timing and nature of rate hikes globally

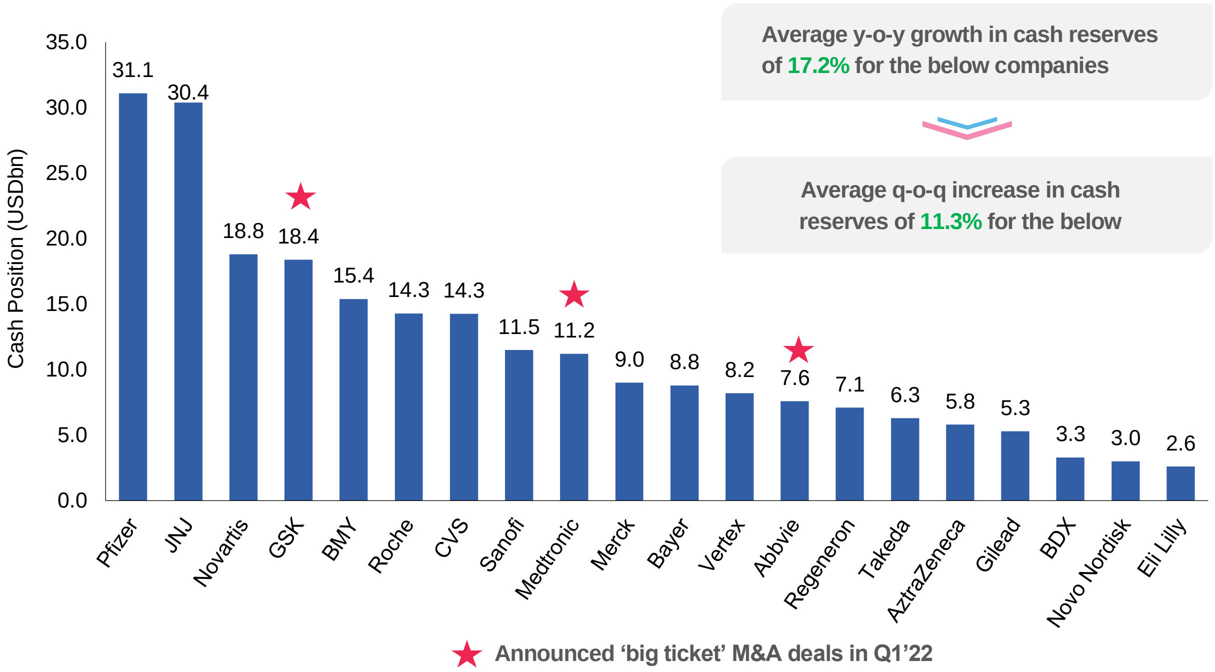
Key Big-Ticket ECM and DCM Deals in 2022

Offer Date	Company	Target's Domicile	Deal Value (USD mn)	Stock Exchange	Deal Type
05-May-22	Bausch & Lomb	Canada	630	NYSE	IPO
28-Apr-22	Royal Philips	Netherlands	~2200	Luxembourg SE	Debt
31-Mar-22	Sanofi	France	~1,700	Euronext Paris	Debt
31-Mar-22	Novo Nordisk	Denmark	~1,700	–	Debt
22-Mar-22	Bayer	Germany	~1,500	Luxembourg SE	Debt
21-Mar-22	GSK	UK	~8,750	London SE	Debt
10-Mar-22	Roche	Switzerland	~4,300	SIX	Debt
06-Mar-22	HCA Healthcare	US	~6,000	NYSE	Debt
25-Feb-22	Roche	Switzerland	~3,400	SIX	Debt
15-Feb-22	Bristol-Myers Squibb	US	~6,000	NYSE	Debt
20-Jan-22	Community Health Systems	US	~1,535	NYSE	Debt
07-Jan-22	Intra-Cellular Therapies	US	460	Nasdaq	Follow-On

Source: Company filings, FactSet as of May 05, 2022

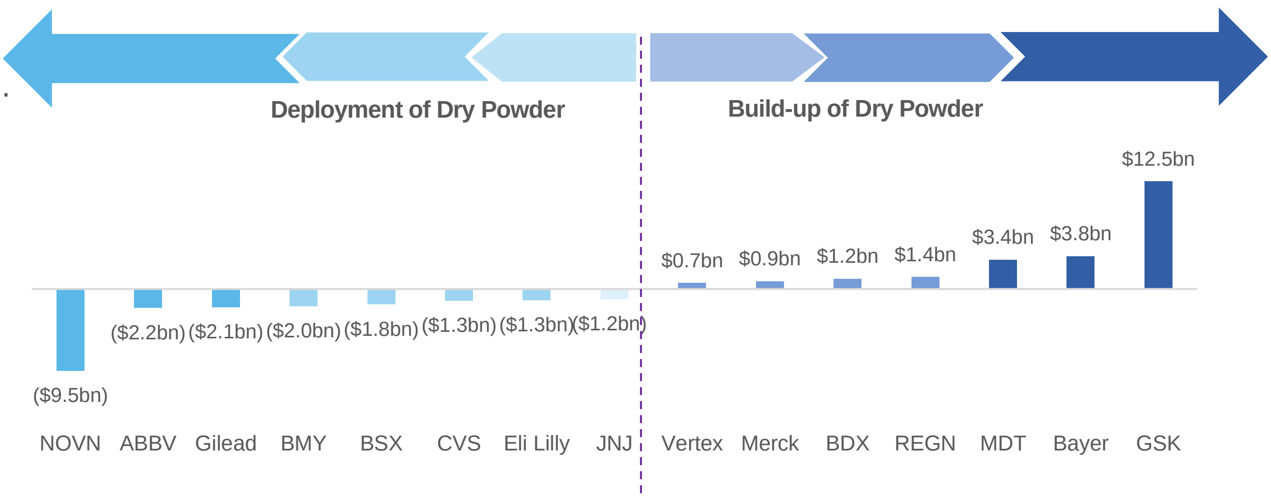
The impetus from capital markets over the course of the past year had resulted in major healthcare providers undertaking multiple financing rounds and accumulating plenty of dry powder. They are actively 'shopping' for potential targets and aiming to close out deals in order to enhance their portfolios and expand market share, despite the ongoing uncertainties surrounding COVID-19, economic recovery and the ever-changing political landscape.

Major Healthcare Consolidators: Dry Powder Ready for Further Deployment



Source: Company filings, FactSet as of March 31, 2022

Even though deal activity suffered in the first quarter, the below chart provides strong evidence that majority of the key consolidators had deployed some of their dry powder post identification of key assets. However, the decline in 'big ticket' deals signifies that dealmakers are adopting a more cautious approach to screening of targets. While others, who still had some headroom relating to their leverage positions, continued to shore up their balance sheets to lock in low interest rates. However, given the recent slowdown in financing, it seems that these consolidators have reached peak cash runaways and will be on the look out to smartly deploy their reserves to better streamline their balance sheets and portfolio.

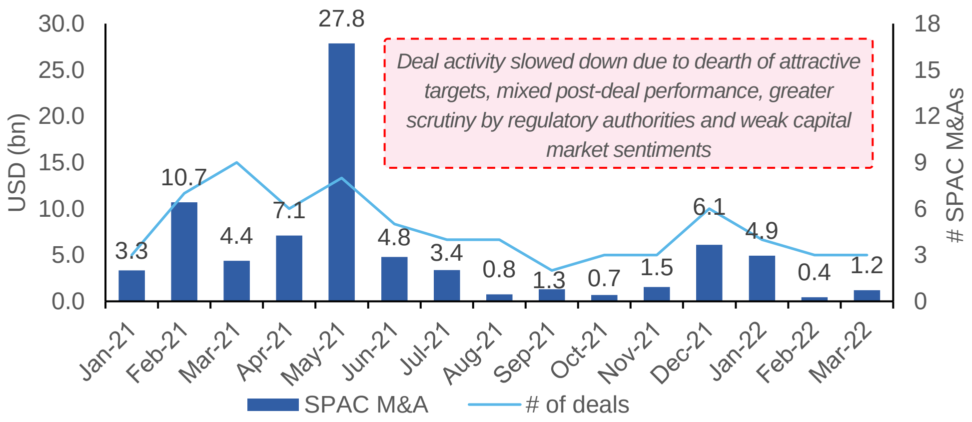


Source: Company filings, FactSet as of March 31, 2022; figures represent changes in cash position since December 31, 2021, in USD

Healthcare SPACs: Regulatory Scrutiny and Litigation Risk

After creating record highs in H1'21 the Special Purpose Acquisition Companies (SPACs) activity has cooled down. The heightened regulatory scrutiny has 'put the brakes' on SPAC IPOs. In March 2022, the Securities Exchange Commission (SEC) in the U.S. proposed new rules and amendments intended to enhance disclosure and investor protections in SPAC IPOs and business combination transactions between shell companies, such as SPACs, and private operating companies. This along with concerns around mixed post-deal performance, rising redemptions during De-SPAC, weak PIPE market and potential overcrowding has resulted in growing investors' doubts about SPACs' ability to deliver high-quality companies. However, the Healthcare sector has been the most active for De-SPAC deals volume in Q1'22 as acquirers sought out targets that will deliver revenue synergies, unlock international growth and bring in enhanced capabilities. Data for recent quarters also show some minor uptick in SPAC IPOs suggesting a healthy De-SPAC activity for the remainder of 2022.

Healthcare SPAC M&A Activity: Merger Clock Continues to Tick Louder in 2022



Source: Refinitiv; deals as of March 31, 2022

Digital Health and Biotech companies continued to be SPACs' magnets given their ability to garner higher valuations compared to other sub-sectors. Overall SPACs continue to close out deals in record time though volume of financing has taken a back seat in the wake of greater investors' scrutiny and a muted capital market

The broad availability of pharma innovation and digital health's growing applicability is expected to sustain the current momentum of Healthcare SPAC M&A activity in 2022 though in a more 'normalized' market

According to S&P Global Market Intelligence data, around 107 SPACs that listed parts of the healthcare industry as their intended target went public in 2021. Though SPAC IPOs declined drastically in Q1'22, competition is expected to increase for De-SPAC deals throughout 2022 as the 'merger clock' keeps ticking and the feasible target universe continues to shrink.

Market Outlook 2022

- SPACs continue to provide an opportunity to put forward a more complicated equity story aided by the ability to use projections especially in the case of high-growth healthcare companies
- Larger pool of investors and higher liquidity than in traditional private equity investments
- Overcrowding has resulted in lack of sizeable and attractive private healthcare companies
- High uncertainty about the business being acquired given shrinking valuations post De-SPAC
- Private securities plaintiffs have also intensified their focus on De-SPAC transactions
- Short-selling activity and volatile financial results post-De-SPAC continue to raise concerns
- Poor performance and heightened regulatory scrutiny have forced investors to tread cautiously
- PIPE funding may reduce as investors cast doubts over target valuations and other deal terms

ESG in Healthcare: Crisis-resilient Long-term Value Creation

In the Healthcare industry, an Environmental, Social and Governance (ESG) framework aims for sustainable energy and waste management systems, investments in community health, addressing unmet medical needs, and requires leaders to embrace diversity and inclusion as their foremost duties. Companies with dynamic business cultures were relatively more resilient during the shutdowns, given their ability to absorb the 'shock'. Globally, investors have started to recognize the potential benefits of announcing an acquisition that is ESG accretive. By directly linking ESG factors to long-term value creation, companies can substantially alleviate investor concerns by de-risking their investments.

The Advent of an 'ESG premium' is Expected to Directly Impact Due Diligence

From a funding standpoint, the cost of capital for companies with better ESG scores is lower than for companies with lesser scores. For example, there is greater investor demand and better pricing for issuers of many green, social, or sustainable bonds versus traditional (non-ESG) issuances. This trend has also gained prevalence among shareholder activists, who have started to include ESG improvements as an important criterion when targeting companies. Since the start of the pandemic global issuance of sustainable debt capital across all industries are at an all-time high. As a result, companies are upgrading their disclosures, culture, and practices towards a more ESG-friendly approach.

In the context of M&A, understanding the disparities between buyers and sellers' ESG profiles has become essential for a successful deal. As a result, deal makers continue to place greater emphasis on ESG criteria while screening out assets and determining valuations across geographies and sub-sectors.

Outlook 2022: Spotlight on Resilience and Transformation

The first quarter of the year saw deal activity decline to its lowest levels since the start of the pandemic. Despite the slowdown, the long-term fundamental M&A themes remain intact. We expect the deal activity to rebound during the year although not at the levels witnessed in 2021. In the light of these developments, we foresee the following key M&A trends to define the overall deal-making for 2022:

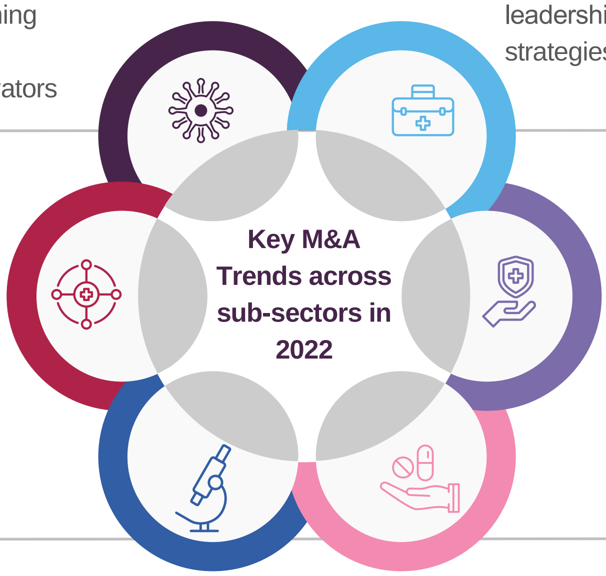
1. **Geo-political tensions continue to dominate client discussions:** The Ukraine conflict and the associated global supply chain disruptions has put the brakes on the record deal activity that we had witnessed last year. For deal makers, market timing has become the strongest headwind in the current environment. Dialogues with related parties should carefully weigh-in the challenges of value-creation post-merger.
2. **Innovation continues to be rewarded:** We continue to foresee any incremental M&A push to be broad-based across major healthcare sub-sectors, as innovation gets rewarded by investors. These include companies that are directly involved in addressing the spread of COVID-19, like those focused on diagnostics and vaccine development, as well as consolidation among medical devices manufacturers, which were severely impacted by restrictions on elective during the start of the pandemic.
3. **Estimated dry powder of ~USD1.3tr among private equity firms:** The strong capital position of private equity firms continues to create opportunities for them to assess and capture resilient healthcare assets. Dealmakers have always found a way to navigate uncertainty and make profitable investments even during high market volatility.
4. **Vaccine developers continue to gain market share:** Successful vaccine developers will continue to earn a windfall of excess cash and market positioning given enormous demand for their products. These companies will be able to reshape the competitive landscape of the pharmaceutical industry. Additionally, the companies which have utilized the new mRNA technology to develop their vaccines have earned an important first-mover advantage in the innovation process of applying mRNA to other therapeutic areas.
5. **Scarcity of attractive assets may serve as a 'deal-breaker':** Unprecedented surge in deals in the last year backed by a 'liquidity flush' may result in an overheated market in in 2022. Investment banks might find it tougher to negotiate terms between the parties due to a lack of available white space and valuation gap between buyer and seller especially during high market volatility.
6. **Scrutiny on the rise for mega M&As:** Governments and antitrust enforcers across the globe are teaming up to rethink their approach toward large mergers' review. This is expected to curb transactions that are responsible for raising prices or dampening innovation across the sub-sectors.
7. **Heightened shareholder activism:** Aided by market volatility and increasing valuation multiples, activist investors found major success in 2021. The activist investors are in a strong position to identify and target companies ripe for activist involvement with focus on extracting value and generating 'alpha' returns.
8. **Cross-border deal activities to remain muted in the near-term:** Geo-political tension, inflationary pressure, rising interest rates and global volatility has propelled corporates to re-evaluate their expansion plans. We expect this trend to play out in the near-term resulting in lower volumes this year, given the cross-border deals are prone to external 'shocks'.

Biopharma

Deployment of record level of dry-powder to replenish drug pipelines & find synergies amid looming patent cliff and the race for acquiring early-stage innovators

Medical Devices

Focus on vertical integration of supply chains, establishing category leadership and 'buy and build' strategies are expected to drive M&As



Healthcare Technology

A M&A hotspot, with the rising valuations of HealthTech and start-ups amid growing importance of contactless healthcare delivery

Healthcare Services

Mostly a buyer's market, with capital availability, evolving competitive dynamics, scalability and commitments to patient-centricity garnering premium valuation

Diagnostics and Labs

Cash infusions during the pandemic are expected to be re-invested in core areas or adjacencies in other related businesses

Pharma outsourcing

Fragmented market, enhanced demand for smarter trial design, biologics and bioreactor development to attract consolidation among major players, pharma companies and sponsors

It is highly unlikely that we will witness the exceptional valuations as that of last year. Hence, both buyers and sellers should adopt creative approaches (partnerships, joint ventures) to generate strategic value as traditional synergies become less relevant in the current market volatility. Cross-sector deals should become more prominent as existing players and new entrants alike push for ecosystem strength throughout the healthcare value chain. Prime focus will be to remain agile and push for innovative business models and optimization of corporate portfolios in midst of ever changing geo-political landscape.

Global dealmakers have a tricky road ahead, with the potential for the advent of new COVID-19 variants, economic sanctions, inflationary pressure and rising interest rates creating challenging headwinds that require smart dialogues with demanding clients.

However, considering the importance of the healthcare industry's role in the current pandemic and beyond, we continue to foresee many new companies (such as Infrastructure Funds, FMCG and large technology companies) entering this space to diversify their business portfolios. These companies armed with marketing expertise, global footprint and strong balance sheets could change the healthcare sector's landscape in the days to come.

If the last few years are anything to go by then we are amid one of the most robust and broad-based M&A markets witnessed in the last few decades. Hence, we continue to believe that the uptake in digitalization, robust demand supported by a more strengthened supply chain, and the availability of M&A firepower with strategics, sponsors and SPACs will help in reviving the momentum in M&A activity for the remainder of 2022.

Author

Arjun Paul

Manager, Corporate and Investment Banking LoB

Over 7 years of experience in working as part of an investment banking offshore teams with a focus on the healthcare industry

Evalueserve Disclaimer

The information contained in this report has been obtained from reliable sources. The output is in accordance with the information available on such sources and has been carried out to the best of our knowledge with utmost care and precision. While Evalueserve has no reason to believe that there is any inaccuracy or defect in such information, Evalueserve disclaims all warranties, expressed or implied, including warranties of accuracy, completeness, correctness, adequacy, merchantability and / or fitness of the information.