EVALUESERVE

Global Healthcare Industry

M&A and Capital Market Landscape H1 2023 Review

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Global Healthcare M&A H1'23: Big-Ticket Deals Demonstrate Resiliency

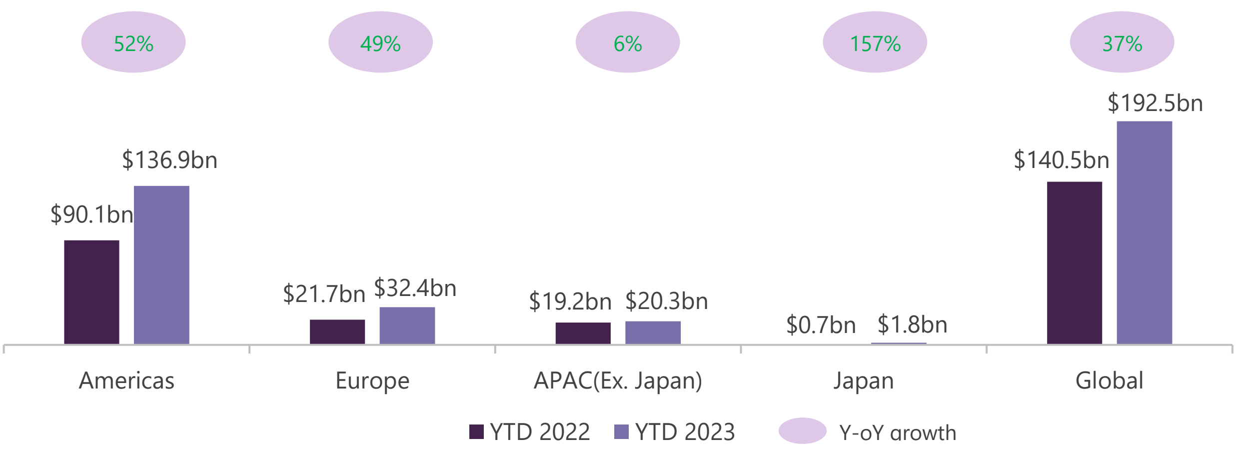
The global healthcare market witnessed a surge of deals in H1'23 as dealmakers returned with the intention to stay ahead of the deal curve. The COVID-19 knock-on effects, labour force displacement, geopolitical unpredictability, and liquidity scarcity that dominated talks last year had subsided, thereby providing a conducive environment for deal making. The ability to identify, negotiate and realize value from increasingly complex partnerships and alternative collaboration models continues to a key competitive advantage.

The sector witnessed numerous 'big ticket' agreements as well as solid deal closures, both of which are expected to drive investors' confidence and set the tone for the remainder of the year. The volume of deals withdrawn during the first half was extremely low, a stark contrast to last year, which saw deals taken off the market on account of geo-political and economic uncertainties. Dealmakers continue to amend their strategies to bridge the valuation gaps. They are conducting deeper analyses of the targets, thereby extending duration of negotiations and due diligence.

Key M&A sentiments observed during the year:

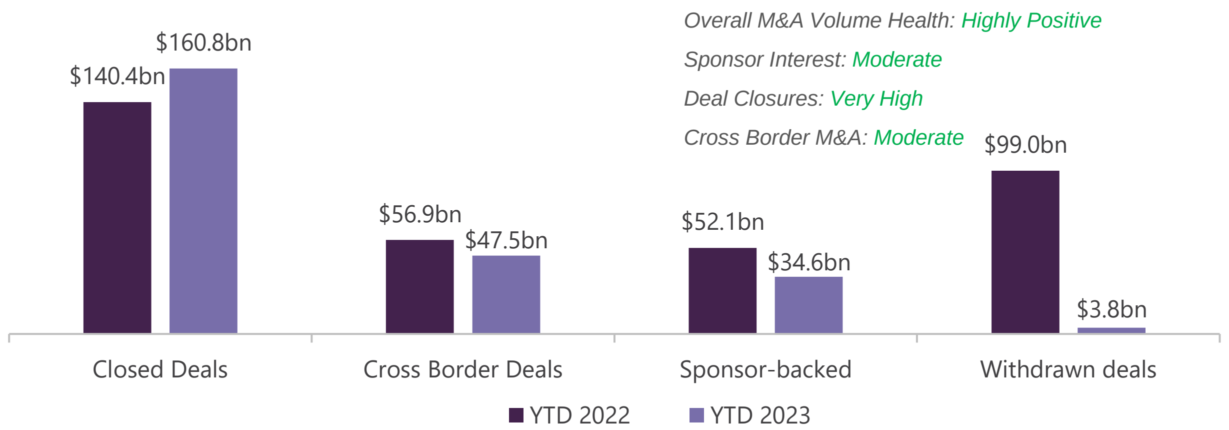
- Even while greater antitrust scrutiny from authorities has made transformative mega deals more difficult to accomplish, M&A remains a crucial transformation instrument for business leaders
- Portfolio realignment is happening among the strategics to divest non-core or under-performing assets; the proceeds of which are expected to be used in ramping of R&D, technology, and scale
- Rapid paradigm shift towards utilising data and actionable insights to implement person-centric network/product strategies across sub-sectors
- Uncertain geopolitical environment and higher interest cycle continue to put pressure on justifying synergies and ROIs
- Sponsors being cautious and revising their expectations to factor in the changing deal making landscape with lower valuations justifying 'firepower' deployment during the year
- Scarcity of initial public offerings made sale processes the primary investor exit method

Global Healthcare Regional M&A YTD 2023 (US$ bn)



Source: Refinitiv; deals as of July 13, 2023

Global Healthcare M&A Volume Analysis (US$ bn)

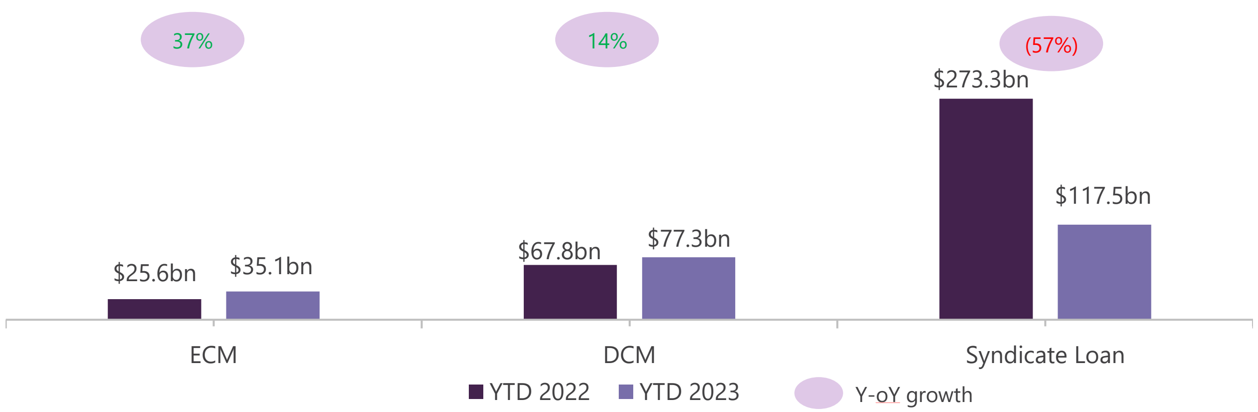


In H1'23, investors continued to view the healthcare sector in terms of its historical status as a "go-to" market amidst uncertainty and engaged in 'big ticket' deals, highlighting the industry's resilience and attractiveness as strong long-term value generator

Healthcare Funding: Focus on Quality as Markets Starts to Rebound

In the Debt Capital Market (DCM) credit conditions continue to tighten, however issuers have largely been able to push out near-term maturities this year. The increase in issuance in 2023 may have been influenced by a resurgence in M&A activity in March; at the same time, several large corporations have been compelled to return to the debt market to refinance debt as previous debt matured (Investment grade securities). Demand in the syndicated loans market remained muted due to concerns over profitability, rising costs of debt and a reversion to more conservative underwriting standards. The resurgence in Equity Capital Market (ECM) activity was driven by perception of stability in interest rates, strong base effect (soft y-o-y figures) and the economy and listing companies' willingness to accept valuation resets. The IPO pipeline continues to grow and with some early indications of macroeconomic stability, a stronger pick up can be anticipated in the second part of the year.

Global Healthcare Capital Markets Activity YTD 2023 (US$ bn)

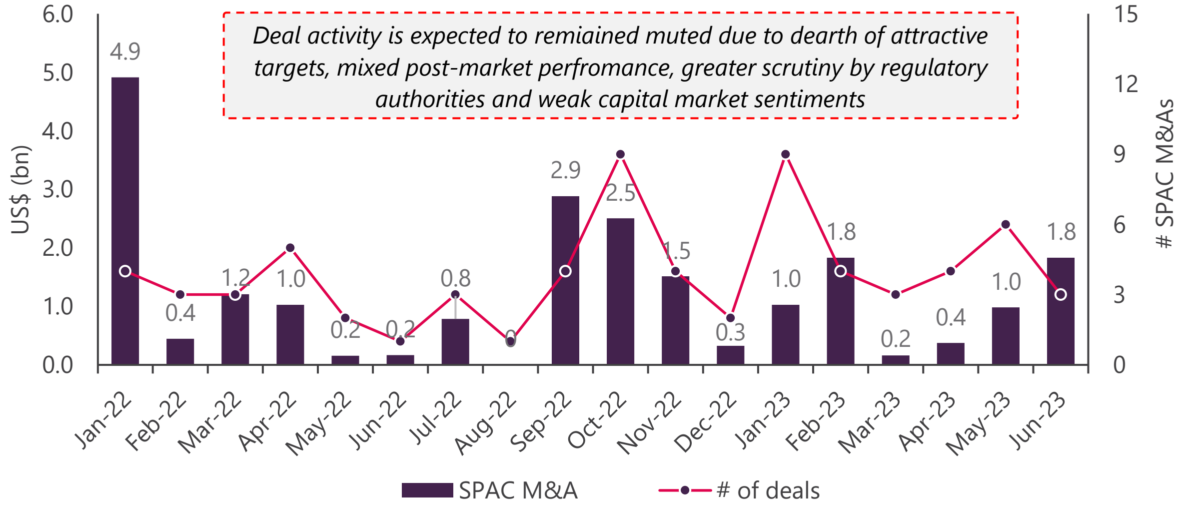


Source: Refinitiv; deals as of July 13, 2023

Healthcare SPACs: Imminent Liquidations as the Merger Clock Expires

The success or should we say the existence of the SPACS going froward will be heavily dependent upon their ability to adapt to the changing financial legislation and competitive environment. The heightened regulatory scrutiny along with excessive redemptions during De-SPAC, a virtually non-existent PIPE market, overcrowding and “SPAC-off” processes have diminished the traditional appeal to investors. Though funding has dried up in the last one-year, innovative deal structures and better due diligence can still revive investors’ faith and stability. In terms of deal volumes, we can at the most expect pre-peak levels to be the new normal in H2’23. For the first time in over 3 years there will be scarcity in the SPAC market, which in turn can provide opportunities as witnessed in MedTech and Biotech sub-sectors during H1’23. Overseas targets are more in focus than ever and sponsor economics are more negotiable with the rising number of redemption mitigation mechanisms. High interest rates and expectations for future interest rate increases in July further prolonged the dry spell for SPAC IPOs, which frequently list on the stock market to raise money and buy other businesses.

Healthcare SPAC M&A (de-SPAC) Activity Remained Muted in H1’23



Source: Refinitiv; deals as of June 30, 2023

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

In the healthcare industry, an environmental, social, and governance (ESG) framework aims to create sustainable energy and waste management systems, encourage investments in community health, and address unmet medical needs; it also requires leaders to embrace diversity and inclusion as their foremost duties. The COVID-19 pandemic has demonstrated that adhering to ESG factors is key to crisis-resilient long-term value creation. 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 2023: Spotlight on Repositioning and Transformation

As we look ahead, deal activity is expected to pick up, especially in the pharma / biotech sub-sectors, given the availability of large dry powder among the major consolidators. Dealmakers, who have been side-lined due to geo-political uncertainty and market volatility, will be eager to structure deals that enable both buyer and seller to transform their business models for the future.

More normalized valuations levels across the healthcare industry, aided by healthy demand from sponsors, the need for replenishing drug pipelines, the buy and build approach of major companies, and the revival of the credit market should drive volumes higher compared to what we have witnessed in 2022.

In the light of these developments, we foresee the following key M&A trends to define the overall deal-making in H2'23:

Geo-political tensions continue to dominate client discussions: An unstable political landscape has disrupted the global supply chains and had 'put the brakes' on the record deal activity that we had witnessed during the pandemic. 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.

Estimated dry powder of ~US$2.0tr among private equity firms: The strong capital position of private equity firms continue 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.

Record levels of deal making firepower is available amongst key consolidators: Leading biopharma companies are having a huge reservoir of cash with an estimated US$1.4bn worth of firepower at the beginning of December 2022 (as per EY report). Reduced deal premiums, patent expiry and dearth of innovative in-house pipeline should propel deal activity in H2’23.

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/were 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.

Scarcity of attractive assets may serve as a 'deal-breaker': Unprecedented surge in deals in the last few years backed by a 'liquidity flush' has resulted in an overheated market. 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.

Impact of Inflation Reduction Act (IRA) on pharmaceutical pricing: While it is unclear how the IRA will affect prices in the long run, it is obvious that there will be major effects, possibly for indications and treatments with very large R&D expenditures. As a result, partners are beginning to think about including customized terms in contracts to address the effects on downstream price.

Scrutiny on the rise for Mega M&As: Governments and antitrust enforcers across the globe are teaming up to rethink their approach towards large mergers' review. This is expected to curb 'mega-deals' which are responsible for raising prices or dampening innovation across the sub-sectors.

Heightened shareholder activism: Given the market developments, shareholder activism should continue to be focused on M&A, strategic operations and shifts in capital allocation. 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.

Key M&A Trends Across Sub-sectors in 2023

01 Biopharma

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

02 Medical Devices

M&As expected to be driven by focus on vertical integration of supply chains, establishing category leadership, and 'buy and build' strategies

03 Healthcare Services

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

04 Pharma Outsourcing

Consolidation expected among major players, pharma companies and sponsors due to fragmented market, enhanced demand for smarter trial design, biologics, and bioreactor development

05 Diagnostics and Labs

Cash infusions during pandemic expected to be reinvested in core areas or adjacencies in other related businesses

06 Healthcare Technology

M&A hotspot, with rising valuations of healthtech and startups amid the growing importance of contactless healthcare delivery

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

How Evalueserve Can Help

Evalueserve has extensive experience working with large, mid-market investment, and boutique advisory firms that deal with franchising companies across sectors such as sports, education, home improvement, entertainment, health and wellness, and food and beverages. Our resources are experienced and qualified to support clients with in-depth analysis and detailed presentations. The Evalueserve team works as an extended team for clients and helps them in matters such as identifying and profiling potential targets / buyers with relevant metrics, financial and operational benchmarking, financial modelling and valuation, benchmarking of franchise financials, confidential information memorandums, detailed management presentations, indications of interests, live deal support, and deal marketing.

Read more about our end-to-end deal support at Corporate Finance Research Consulting | Evalueserve.

To know more about our investment banking offerings, visit our webpage: Investment Banking Advisory - Evalueserve.

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