PG Briefing
September 15, 2021

Private Equity and Health Care Investments: How Has COVID-19 Impacted Deal Flow?

Arielle Schmeck, CPA/ABV, CM&AA (JTaylor)

This article is brought to you by the Transactions Affinity Group of AHLA's Business Law and Governance Practice Group.

Entering 2020, private equity (PE) investment in health care services was on pace to surpass historic rates of investment in the industry, despite PE health care deal activity achieving record highs in the preceding years (2019 total deal value reached an all-time of $74.4 million, which is a 23% compound annual growth rate since 2014).[1] However, by mid-March 2020, the health care services deal space, along with most other transaction activity, came to a complete halt as the COVID-19 pandemic forced businesses to close and created significant economic uncertainty. While many industries saw a significant decline in total investment throughout the remainder of 2020, many PE investors turned to the health care services arena as somewhat of a safe haven as the U.S. economy began to re-open in the second half of 2020. In total, while deal value decreased by 7% from 2019 to 2020, total deal count increased by 10% as more investors looked to add-on to existing platforms rather than seeking out new, larger targets of interest.[2]

This increased deal activity, which saw a particularly large surge in the fourth quarter of 2020, has continued throughout the first half of 2021. This article examines PE health care deal activity pre- and post- emergence of COVID in the United States and key drivers in PE health care investment throughout this time period.

Comparing 2020 to 2021 Investment Activity

As the global COVID-19 pandemic began to force shutdowns in March 2020, a significant portion of deal activity followed suit. Reported active M&A deals in June 2020 were down 46% from pre-COVID levels.[3] Additionally, not only were buyers and sellers not entering into new transactions during the second quarter of 2020, but many deals that were in process before COVID hit were either suspended or terminated. In one survey conducted by the Alliance of M&A Advisors, respondents indicated that 40% of the deals in-process in February 2020 were suspended/on-hold in June 2020 and another 14% had been terminated by either the buyer or seller.[4] However, health care transactions had the highest successful close rate of any industry (approximately 32%), even ahead of information technology and information data/content/delivery.[5]

While the number of deals closed during the summer of 2020 remained somewhat depressed compared to prior periods, more than 200 health care deals closed between June 1, 2020, and September 30, 2020, according to PitchBook.[6] Sellers varied across the health care industry spectrum, including dermatology, radiology, home care, medical devices, and other health technology (healthtech) companies. Across all industries, deal activity remained strong into the last quarter of 2020, particularly in December, which saw reported deal activity back to 97% of pre-COVID levels.[7] Overall, the number of deals closed in 2020 was down only 11% from 2019 since the high volume of activity late in the year made up for the pause in transactions during the early months of the pandemic.[8] Hundreds of deals in the health care industry closed during the fourth quarter, including some PE-backed "mega-deals" (transactions between companies with combined revenues in excess of $1 billion), including:

- The Vistria Group and Centerbridge Partners leveraged buy-out (LBO) of Help at Home;
- Aspen Dental Management's LBO of ClearChoice (via its financial sponsors); and
- Radiology Partners' LBO of Mednax (via its financial sponsors).[9]

In total, PE deal activity in the health care sector remained relatively consistent as a percentage of total deals between 2019 (15.6%) and 2020 (14.1%).[10]

Entering 2021, the transaction market remained very active. Many PE firms were seeking to invest dry powder that had accumulated throughout the pandemic, in addition to having the ability to obtain cheap debt financing due to low interest rates. The shift to a new presidential administration and anticipated tax increases caused many sellers to look to make exits ahead of a potential capital gains tax hike. Because both buyers and sellers had motivations to complete transactions, over 3,700 deals closed in the first half of 2021, worth a combined $456.6 billion—approximately two thirds of the total deal value transacted in all of 2020.[11] The second quarter of 2021 had the second highest deal activity in a decade, trailing only the fourth quarter of 2020 which, as noted above, was unusually high as buyers and sellers pushed to close deals before the end of the year.[12]

Continuing the trend from the end of 2020, PE investment in the health care sector remained popular as a number of new opportunities arose out of the pandemic, including telehealth, behavioral and mental health, and other areas of interest. Many expect this activity to continue into the future as investors look to expand or add new areas of growth to their portfolios.

Drivers in PE Health Care Investment

As described above, PE health care investment has increased dramatically in the past decade. This increase in activity is driven by a variety of factors, including relatively reliable revenue streams stemming from an aging population and the rise in per-capita health care spending. Still, a few key opportunities have spurred much of the activity in recent years.

First, PE has targeted the health care industry due to its relatively fragmented nature, particularly in the provider space. PE firms have utilized a "roll-up" strategy to aggregate smaller providers into larger organizations in order to achieve economies of scale, provide more efficient administration and expertise, and potentially access higher commercial reimbursement rates. Historically, PE has been aggressive and successful in rolling-up specialty practices such as dermatology, radiology, and dentistry. Other specialties that have received PE attention include pain management, orthopedics, and other traditionally high-reimbursement specialties.

One area that has historically seen less PE activity is primary care, though that seems to be changing. As value-based care and capitated payment models (where providers are paid a fixed rate to manage an individual's care rather than billing for each service) become more popular, PE investors are seeking an opportunity to share in some of the cost-savings and efficiencies, as well as improve clinical outcomes through data analytics and information sharing across their platform entities.[13] Around 80% of states now use capitated payment models for Medicaid,[14] and Medicaid enrollment has increased, particularly given COVID's impact on the labor market. Additionally, a growing number of Medicare beneficiaries are choosing to enroll in capitated Medicare Advantage plans rather than the traditional fee-for-service Medicare program. In fact, participation in Medicare Advantage is expected to outpace enrollment in traditional Medicare in less than ten years.[15] The growth in capitated plans, coupled with this model's incentive to control costs while improving clinical outcomes, will likely continue to fuel PE's investment in primary care in the near term. The amount of activity is yet to be determined, however, as a large portion of primary care providers are already employed and/or affiliated with large health systems.

In addition to primary care, PE buyers are attracted to behavioral and mental health, as well as home care providers. As mental health continues to become more destigmatized (accelerated somewhat by the pandemic), and reimbursement increases for these services, PE is looking for opportunities to consolidate one of the more fragmented areas of the health care provider spectrum. Within behavioral health, PE buyers appear to be particularly interested in outpatient care, autism, and intellectual and developmental disability services.[16] As it relates to home care providers, hospice and dialysis have been popular areas of investment, as these services remained relatively unaffected by COVID.[17]

The last area that has seen a significant increase in PE investment recently is healthtech. While COVID led to exponential growth in telemedicine and telehealth, the continued reliance on technology, data analytics, and informatics has also increased deal activity in this space. With the shift to value-based care and capitation payment models, physician groups and other health care providers are increasingly reliant on accurate, real-time data to manage their patient populations effectively and efficiently without having to increase the number of patients visits and/or procedures.[18] In addition to health care data analytics companies, another growing area within healthtech is health insurance technology. These companies provide solutions for health insurers in order to better manage patients' benefits by streamlining prior authorizations, eligibility, insurance verification, etc. In addition to PE interest, many insurers are also looking to acquire these entities in order to vertically integrate and bring cost-savings in-house.

Looking Ahead

Many of the conditions that have spurred PE activity in late 2020 and early 2021 still exist. In particular, sellers motivated to avoid expected future tax increases will be pushing to close deals quickly. However, the Executive Order issued by President Biden in July 2021 may impact deals going forward, particularly the mega-deals that have been prominent recently. Among other provisions, the Order calls on the Department of Justice (DOJ) and Federal Trade Commission to "enforce the antitrust laws vigorously" and "challenge prior bad mergers that past Administrations did not previously challenge."[19] Furthermore, the Order states that "enforcement should focus in particular on…healthcare markets (which includes prescription drugs, hospital consolidation, and insurance), and the tech sector."[20] This will likely lead to more scrutiny for PE transactions in the health care industry and may extend the timeline for closing deals even if deal activity continues. However, many of the opportunities addressed above with regard to the fragmented segments of the health care industry would not necessarily be of a size that would draw the increased regulatory attention that transactions between large health systems might.

Conclusion

PE investment in the health care industry does not seem to be a trend that will end anytime soon. Despite the lull in deal activity during the early months of the COVID pandemic, PE investment quickly picked back up and ultimately almost matched the historic investment amounts from 2019. If the first half of 2021 is any indication, PE deal activity in the health care space is expected to continue at a strong pace. As PE groups continue looking to deploy their excess dry power, and have access to cheap debt, health care will likely be a popular area of investment, particularly for those with the expertise to navigate the complex regulatory environment. Additionally, given the fragmentation that still exists in the health care provider market, and the growing healthtech arena, there will continue to be areas of opportunity for PE investors even in a climate of increased regulatory scrutiny.

[1] PitchBook, *US PE Breakdown, Q2 2021*. © 2021 by PitchBook Data, Inc.
[2] *Id.*

AMERICAN HEALTH LAW ASSOCIATION

[3] Alliance of Merger & Acquisition Advisors®. *M&A Access 2021 Q2 M&A Market Report*.
[4] Alliance of Merger & Acquisition Advisors®. *M&A Access COVID-19 Report, 2Q 2020*.
[5] *Id.*
[6] PitchBook Data, Inc. *Deal Search criteria: PE-backed deals in Healthcare industry in the US with Closed deals between June 1, 2020 and September 30, 2020.*
[7] Alliance of Merger & Acquisition Advisors®. *M&A Access COVID-19 Report, 2Q 2020*.
[8] *Id*.
[9] PitchBook Data, Inc. Deal Search criteria: PE-backed deals in Healthcare industry in the US with Closed deals between October 1, 2020 and December 31, 2020.
[10] PitchBook. *US PE Breakdown, 2020 Annual*. © 2021 by PitchBook Data, Inc.
[11] PitchBook. *US PE Breakdown, Q2 2021*. © 2021 by PitchBook Data, Inc.
[12] *Id*.
[13] BMO Sponsor Finance. *Transaction Trends.* Q1 2021. © 2021 BMO Financial Group.
[14] *Id*.
[15] *Id*.
[16] Private Equity to Fuel Behavioral M&A in 2021, with Outpatient Models Driving Demand, Bailey Bryant. January 29, 2021, accessed August 10, 2021, https://bhbusiness.com/2021/01/29/private-equity-to-fuel-behavioral-ma-in-2021-with-outpatients-models-driving-demand/.
[17] *Id*.
[18] PitchBook. *The Healthcare PE Investment Landscape: Assessing key investment characteristics, capital flows, and performance in a burgeoning space*. 25 Sep. 2020. © 2020 by PitchBook Data, Inc.
[19] Fact Sheet: Executive Order on Promoting Competition in the American Economy. 09 Jul. 2021.
[20] *Id*.