EVALUESERVE

Global Healthcare Industry

M&A and Capital Market Landscape Q1 2023 Review

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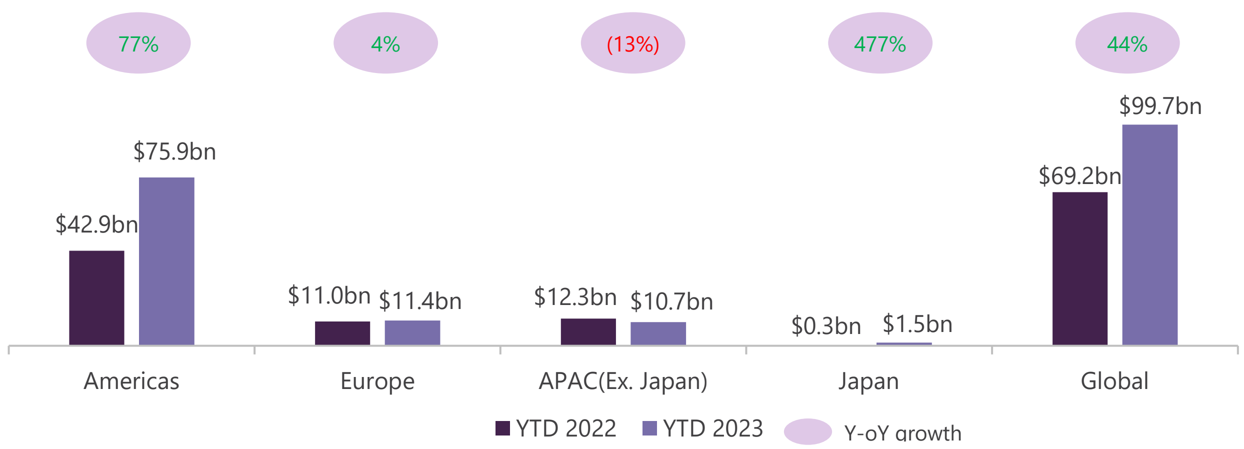
Global Healthcare M&A Q1 2023: Return of 'Big-Ticket' Deals

The global healthcare market witnessed a surge of deals in Q1 2023 as dealmakers returned with the intention to stay ahead of the deal curve. The COVID-19 knock-on effects, labor force displacement, geopolitical unpredictability, and liquidity scarcity that dominated talks last year appear to have subsided. As a result, deal making was relatively higher, compared to a partially muted Q1 2022. Additionally, operational, and financial pressures have driven business to look for transformative partnerships. The ability to identify, negotiate and realize value from increasingly complex partnerships and alternative collaboration models has become an important competitive advantage.

The sector witnessed numerous 'big ticket' agreements as well as solid deal closures, both of which are expected to revive investors' confidence and set the tone for the remainder of the year. The volume of deals withdrawn during the quarter was extremely low, a stark contrast to last year which saw deals taken off the market on account of geo-political and economic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. Considering these developments, we expect the following themes to impact M&A sentiments:

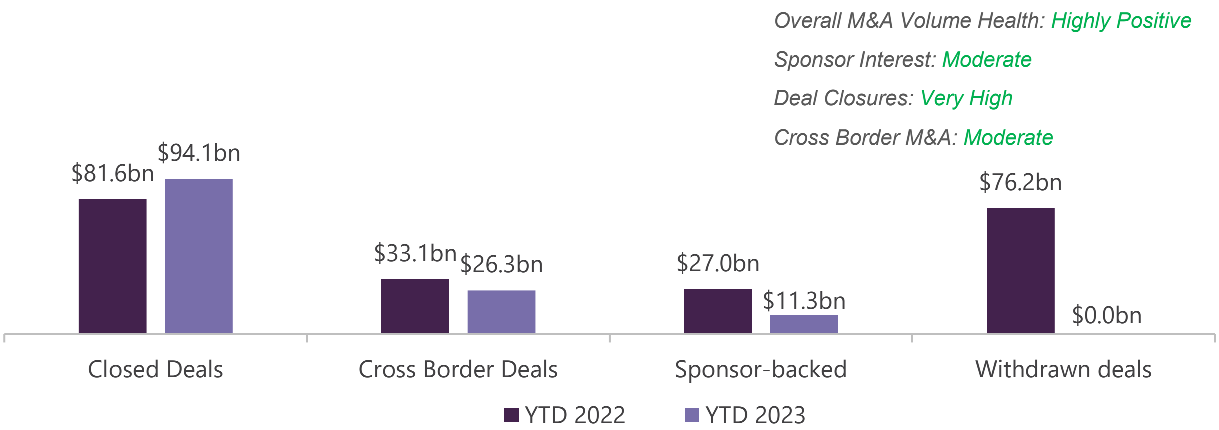
- Portfolio realignment is happening among the strategics to divest non-core or under-performing assets; the proceeds of which are expected to be used in ramping of R&D, technology, and scale.
- There is a rapid paradigm shift towards utilising data and actionable insights to implement person-centric network strategies across sub-sectors
- Uncertain geopolitical environment and higher interest cycle continues 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
- Continued focus on ramping up digital capabilities

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



Source: Refinitiv; deals as of April 13, 2023

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

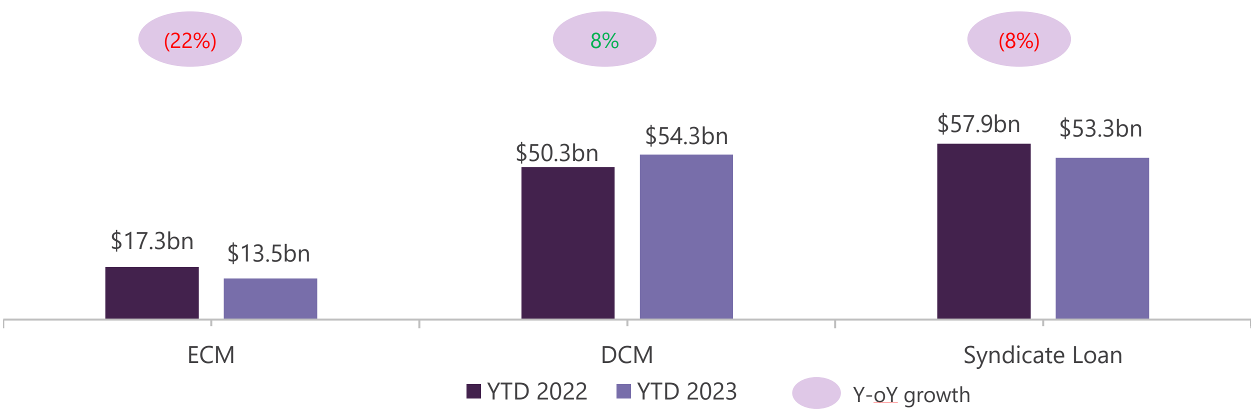


In Q1 2023, investors continued to regard the healthcare sector in terms of its historical status as a "go-to" market during uncertain times, demonstrating the industry's resilience

Healthcare Funding: Flight to Quality Amidst Uncertainty

The financial equity and debt capital markets (ECM and DCM) witnessed contrasting demand in Q1 2023. In a rising interest rate cycle, the DCM observed debtors scrambling to refinance and postpone loan maturities. However, the demand is still mostly driven by investment-grade securities, as evidenced by the decline in worldwide high-yield instrument issuances during the third quarter (indicating a 'flight to quality'). 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 lack of demand for de-SPACs and an unexpected global banking industry turbulence resulted in a decline in the ECM. The IPO pipeline is growing, nevertheless, and with some early indications of macroeconomic stability, a reversal can be anticipated in the second part of the year. We continue to expect inflationary pressure, geo-political scenario, and impact of rising interest rates to be the key factors determining the overall activity in 2023.

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

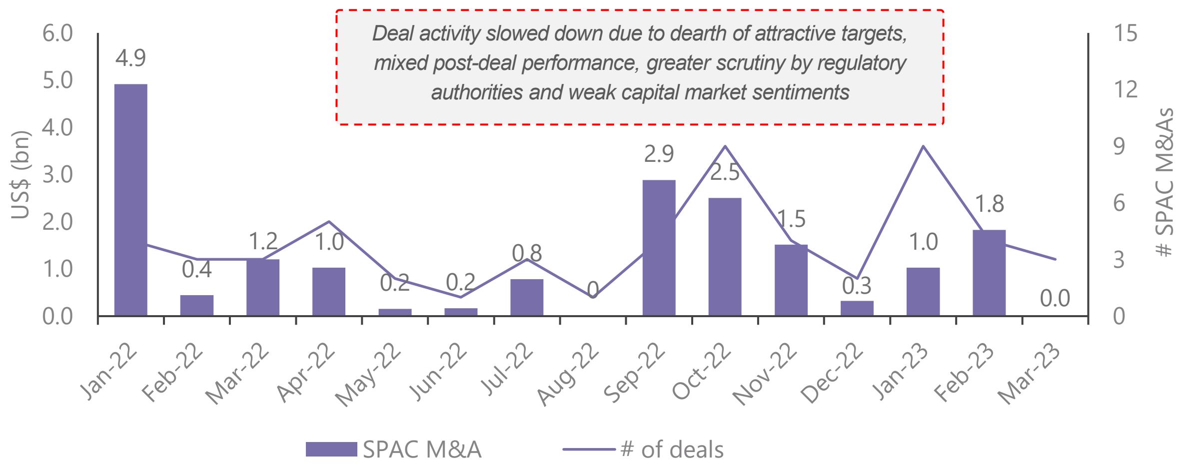


Source: Refinitiv; deals as of April 13, 2023

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 concerns around mixed post-deal performance, excessive redemptions during De-SPAC, a virtually non-existent PIPE market, overcrowding, and "SPAC-off" processes has 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 2023. 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 Q1 2023.

Healthcare SPAC M&A (de-SPAC) Activity Remained Muted in 2023

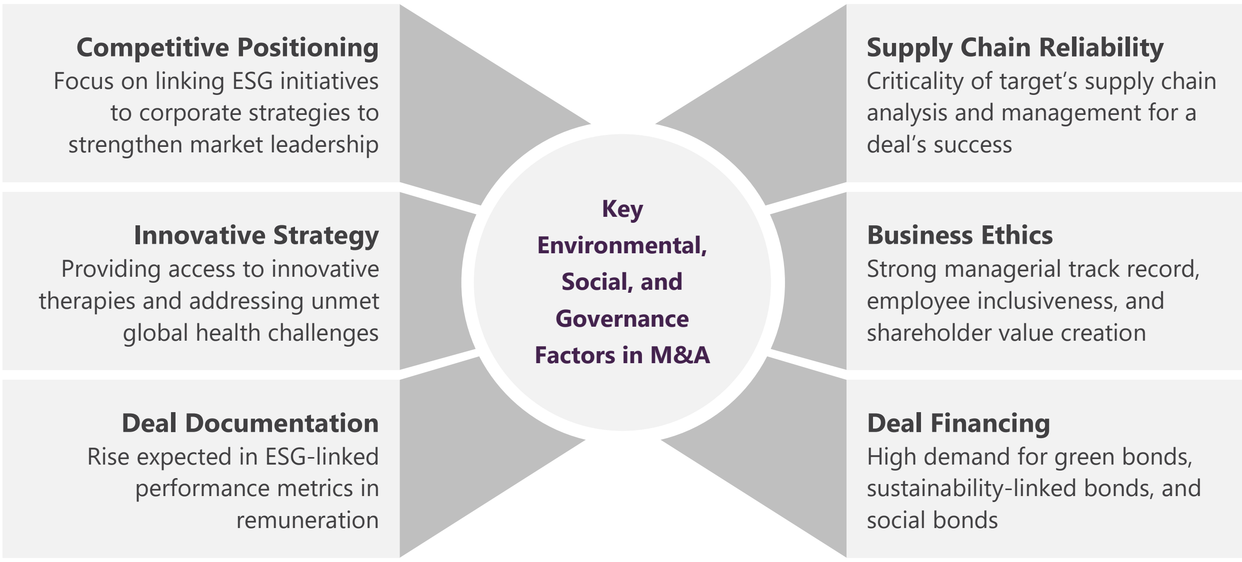


Source: Refinitiv; deals as of March 31, 2023

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 light of these developments, we foresee the following key M&A trends to define the overall deal-making for 2023:

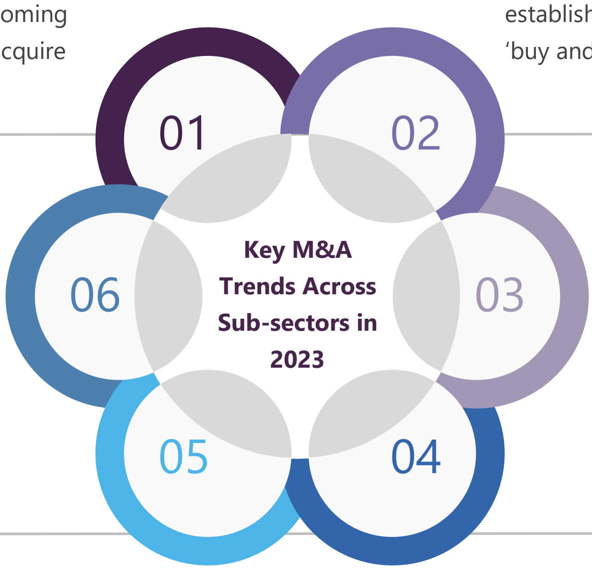
- **Geo-political tensions continue to dominate client discussions:** An unstable political landscape has disrupted the global supply chains and had 'put the brakes' on the record deal activity that we had witnessed during the pandemic. For deal makers, market timing has become the strongest headwind 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 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.
- **Record levels of deal-making firepower are 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 a dearth of innovative in-house pipelines should propel deal activity in 2023.
- **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 device manufacturers, which were severely impacted by restrictions on electives 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' may result in an overheated market in 2023. Investment banks might find it tougher to negotiate terms between the parties due to a lack of available white space and a 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 prices.
- **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 a focus on extracting value and generating 'alpha' returns.

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

Medical Devices

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



Healthcare Technology

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

Healthcare Services

Largely 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 pandemic expected to be reinvested in core areas or adjacencies in other related businesses

Pharma outsourcing

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

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 modeling and valuation, benchmarking of franchise financials, confidential information memorandums, detailed management presentations, indications of interests, live deal support, and deal marketing.

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

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