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The leader in Health Care Services Mergers & Acquisitions

INSIGHT INTO HEALTH CARE SERVICES MERGERS & ACQUISITIONS

THE BRAFF REPORT

# Health Care M&A in the Time of COVID-19

## Sectors That Will Fare Better Than Others

If the images that come to mind when you think about private equity are *Wall Street's* Gordon Gekko or *Billions*' Bobby Axelrod, you'd think these Masters of the Universe eat risk for breakfast.

It turns out they're not quite **that** swashbuckling.

In the tippy toeing act of investing, they're far more comfortable on the balance beam than a tight rope across the Grand Canyon without a net.

No surprise, then, in an economic black hole of unknowns brought about by COVID-19, buyers are more inclined to seek cover **under** the bargaining table than a seat at its **head**.

And the fear is real.

Across all industries, when considering acquisition opportunities, now, more than ever, buyers must ask themselves:

- Are the revenue streams sustainable?
- Will demand – and pricing – hold up?
- Is the past a reasonable proxy for the future?
- If the business has been disrupted, has it bottomed out?
- Is the pathway back to normalcy reasonably predictable?
- Am I confident enough to close a deal amidst the chaos?

Today, then, job one for buyers is to identify sectors that have unique operational and demand characteristics for which the answer to one or more of the above is yes – those that are inherently more resistant to downturns relating to the pandemic (or may even see an upturn).

### In health care services, there are indeed sectors that may very well keep buyers in the game.

To wit, in order of those with the most compelling, of compelling, attributes:

**Job one for buyers is to identify sectors that have unique operational and demand characteristics that are inherently more resistant to downturns relating to the pandemic.**

### Telehealth tells of wealth.

If ever there was a no-brainer in terms of an investment thesis under COVID-19, telehealth would certainly be it. While home officing is in, doctor officing is most certainly out. So, demand is rocketing. Resistance to reimbursement has evaporated.

What's more, from an investment perspective, the convenience, cost-effectiveness, and efficacy of telehealth ingrained in the public **during** the pandemic is virtually guaranteed to survive **well past its end**, boosting telehealth's long-term rate of adoption and utilization.

Add in high-demand behavioral health and the investment becomes practically irresistible. Witness the recent announcement of **UnitedHealth** subsidiary **Optum's** intention to acquire remote behavioral health provider **AbleTo** for an eye-popping 10 times **forward** revenues.

Note that the value proposition here goes beyond telehealth to all manner of **remote patient monitoring** products and services that track basic vitals, EKG and other cardiac measures, disease specific biometrics, and more.

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## SUD-19.

Unfortunately, COVID-19 has led to a viral outbreak of fear, anxiety, depression, and inevitably, substance use disorder. So, over the coming months and likely well into 2021 and beyond, demand for treatment services is going to rise. And with (a) local, state, and federal agencies increasingly devoting resources to treatment initiatives, and (b) growing pressure on insurers to fully comply with requirements to cover mental health "on-par" with medical services, funding to treat this corollary epidemic is **growing**. Accordingly, as attractive as the risk profile of addiction treatment services was **prior** to coronavirus, it is even **more so** today.

Two notes of interest:

One intervening variable in residential treatment is the **interplay** between when an individual decides to seek treatment and the virus-inspired fear of congregate living. This appears to be situationally specific as some providers have seen increases in census during the epidemic, while others have seen some decline.

**With its cost-effectiveness, efficacy, and long length of stay characteristics, medication assisted treatment (methadone and Suboxone) rises to the top [of COVID-19 resistant investment opportunities].**

That said, in a sector that should already fare well under coronavirus, as an alternative to residential treatment, with its cost-effectiveness, efficacy, and long length of stay characteristics, **medication assisted treatment (methadone and Suboxone) rises to the top**. No surprise then, that, even now, the pace of deals in MAT appears unabated.

## I/DD will B-AOK.

The unfortunate reality of those with intellectual and developmental disabilities is that these are lifelong challenges.

**In group homes, stay-at-home is not only a social distancing strategy, but the reason why I/DD is inherently resistant to the economic ravages of coronavirus.**

Accordingly, the revenue streams attendant to the interventions are practically an annuity. This is particularly the case in group homes where stay-at-home is not only a social distancing strategy, but the reason why I/DD is inherently resistant to the economic ravages of coronavirus. This is not to say that group homes are immune from the virus being introduced to residents by outside caregivers. But the risks are smaller and more controllable with a limited, and consistent team of support staff coming in. Moreover, we suspect that for many families and guardians, the social and behavioral consequences of pulling long-term residents from the comfort and familiarity of their programs may outweigh the manageable threat of the virus.

## What's special about specialty pharmacy.

In an excellent survey and article written by Adam J. Fein entitled, "Coronavirus Industry Impact: Patients, Pharmacies, and Wholesalers," Mr. Fein reports wide-spread industry expectations that utilization of pharmacy mail order services will increase during the pandemic. Not surprising, as we see a surge in mail order across all industries as socially distanced consumers avoid in-person transactions. It's not much of a leap, then, to anticipate the same for specialty pharmacy providers. Moreover, with so many specialty Rx services treating long-term, chronic conditions, the pipeline of **existing** patients is unlikely to be disrupted by COVID-19. We may, however, see some **slowdown of new revenues** as would-be customers delay seeing physicians that diagnose new cases and write new prescriptions.

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## Home Medical Equipment – She Loves Me.

Over the past decade, investors have had a “she loves me, she loves me not” relationship with HME. The line graph charting private equity sponsored activity over the period forms a near perfect “M”, with the peaks hitting in 2012 and, most recently, 2018. We suspect the reasons for this flirtation are twofold: On the plus side, after years of cuts, reimbursement has largely stabilized, and could even see some increases. Moreover, HME is increasingly being seen as a “last man standing” opportunity – an environment that beckons PE. The yang to that yin is the sector’s tight margins (which sponsors bet can be addressed with investments in technology and extracting economies of scale).

**HME is increasingly being seen as a “last man standing” opportunity – an environment that beckons PE.**

Amidst the uncertainty of coronavirus, with (a) sustained and perhaps increasing demand (particularly for higher margin respiratory equipment), and (b) largely long-term rental and repeat sale revenue streams, love is back in the air for HME.

## Health care staffing, STAT.

With front-line health care workers pushed well past the brink, there is no question that in the hardest hit areas of the country, the demand for temporary health care staffing is unprecedented. Moreover, it is likely to last longer than the pandemic as physically and emotionally drained caregivers inevitably leave the workforce or are slow to rejoin.

Two cautionary notes:

As obvious an opportunity health care staffing may appear, it is not entirely so.

First, due to fears of the virus, it is challenging for staffing providers to fill the growing surplus of open orders. To do so, many are finding it necessary to substantially increase pay rates. When these increased costs are passed on to clients, we suspect many are reluctantly forced to ration utilization.

Second, as explained in a recent article from Healthcare Dive, with severe drop-offs in elective procedures and non-emergency primary care and specialist physician visits, “the coronavirus crisis has created a **stratified** [emphasis added] impact on the healthcare workforce, with front-line doctors and nurses and select specialists in high demand, while others are finding demand for their jobs is dropping precipitously.”

**[Despite coronavirus] the health care economic policy initiatives that boosted acquisition demand for many health care service businesses are unchanged.**

On balance, though, from a mergers and acquisitions perspective, we anticipate that health care staffing will fare well during and after the pandemic.

## A Couple of Endnotes.

### If your sector is not among the above, it does not mean there will be no activity over the next 6-12 months.

Despite the general characteristics of a space, individual providers may have specific attributes that allow them to better traverse the COVID-19 landscape than their competitors. Moreover, the health care economic policy initiatives that boosted acquisition demand for many health care service businesses are unchanged. For example, while home health and hospice providers may be facing challenges staffing cases or visiting patients' homes or skilled nursing facilities, their value in improving outcomes, driving down costs, and increasing margins in increasingly at-risk global payment models very much remains.

### In a higher risk, credit constrained market that is putting downward pressure on deals across all industries, could some of these health care service sectors see increases in valuation?

In a word, yes.

While this remains to be seen, sidelined buyers with idle money earning next-to-nothing interest will wait the market out for only so long. When they come back, demand for the most pandemic resistant assets will surely outstrip supply. As an early indicator of this, given reduced borrowing capacity, we are already seeing private equity sponsors pledge to fund deals entirely with equity (with expectations to complete a debt recap when the lending environment becomes less hostile).

**As a result, we may very well see this demand imbalance push values up in an otherwise down market.**

Watch this space.

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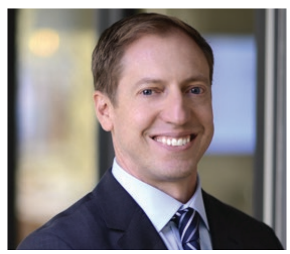

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