



Opportunities abound even as risks rise

**M&A trends in
healthcare**

Q3'22

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Introduction

Healthcare M&A returns to earth

Converging forces sparked record volumes of healthcare M&A transactions in 2021. More than 600 deals were announced or completed per quarter that year, on average, compared to just over 400 in 2022. The pandemic spurred activity in telehealth in 2021, for example, some deals put on hold in 2020 were made in 2021, and some deals closed in 2021 in anticipation of a new administration in Washington.

We believe industry leaders and private equity (PE) firms will continue making hundreds of healthcare (HC) deals per quarter into 2023, including some large ones. We expect these players will tread cautiously, however, as they navigate the threat of recession, continued geopolitical turmoil, supply chain challenges, labor shortages, and higher interest rates that could affect company operating results and reduce buyers' leverage.

The industry's overall strengths will endure—people need care, drugs, and medical devices in good times and bad—but some subsectors should see more action than others. Hot targets in 2021, including healthcare systems, payor and pharmacy benefit management (PBM) targets, and HC IT and digital health companies, have attracted far fewer suitors this year (see charts below).

In this paper, we review HC dealmaking in Q3'22 by sector, including the most notable transactions, and trends in strategic and PE investing. After a deep dive into the risks and rewards of divestitures, we share our outlook on the next several quarters, and recommend three steps that industry leaders should consider now.



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Key statistics: marketplace downshift

-47% Overall healthcare deal volume declined by almost 50 percent in Q3'22 compared to the quarterly average in 2021

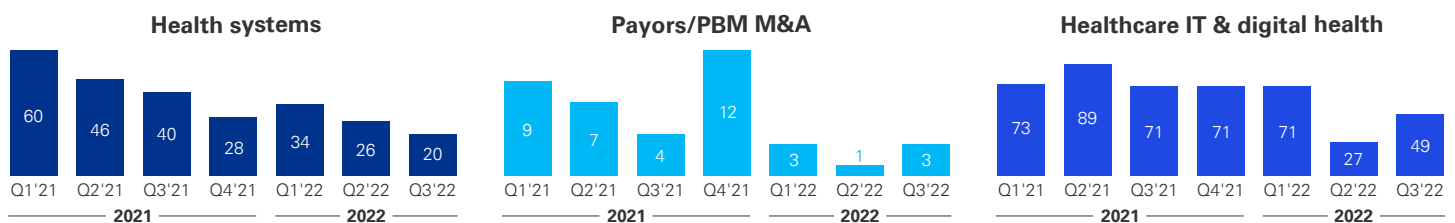
Return to

Average Healthcare system deals fell from a 12-month quarterly average of 32 to 9 in Q3'22. We counted on 8 sales of payor or PBM firms in 2022, compared to 47 in 2021

Simon Hodson on talent shortages:

The talent shortage is having two key effects on HC M&A: pursuing acquisitions to gain access to new talent, bringing back the trend of "acqui-hiring"; and retaining key staff during and after a transaction—a challenge even in a normal labor market but tougher now because they're holding all the cards.

Acquirers pulled back in some subsectors after an exceptional 2021



By the numbers

Lower volume but some major deals

The volume of M&A in the U.S. healthcare sector continued to fall in Q3'22 compared to the first two quarters of the year, and was far below any quarter in 2021. Large deals were made, however. CVS expanded its healthcare services by acquiring Signify, whose 10,000 physicians in 50 states provide care virtually and in person. Amazon also bought a primary care provider, 1Life Healthcare, with 188 offices in 25 U.S. markets. Both deals demonstrated the enduring value of in-person care despite huge growth in digital and telehealth during the pandemic.

Clayton, Dublier & Rice, a PE firm, acquired majority share of Kindred at Home from Humana, apparently aiming to build the skilled nursing care business, an industry that saw value spike in 2020 and 2021.

Appealing targets should continue to entice players looking to gain vital capabilities or enter new growth areas. But most acquirers will be more selective and have less leverage as interest rates climb, and some sellers may be unwilling to accept valuations considerably lower than what they might have expected in 2021.

The number of strategic deals outpaced PE deals in the last two quarters, as shown in this chart, in part because many PE firms are now managing the many acquisitions they made in 2021. We expect them to continue looking for targets in the months ahead, especially deals for under \$200 million, as they build their portfolios.

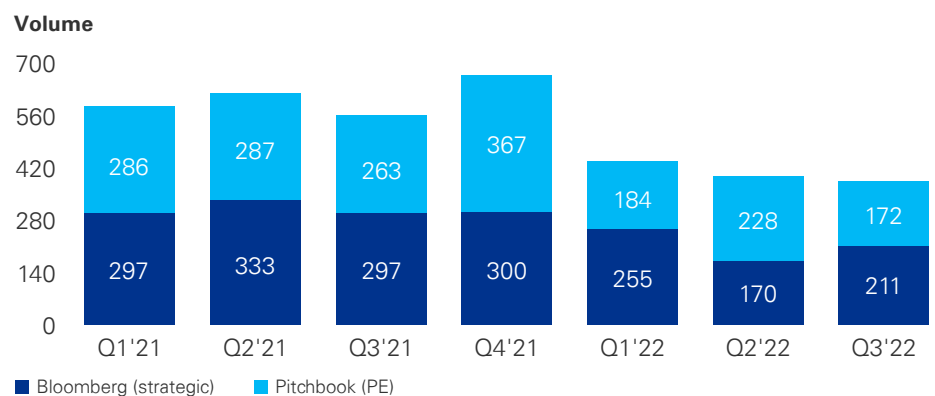
Top healthcare deals Q3'22

| Acquirer | Target | Value (billions) |
|--|-------------------------------------|------------------|
| CVS Pharmacy | Signify Health | \$8.1 |
| Amazon | 1Life Healthcare (One Medical) | \$4.3 |
| Clayton, Dublier & Rice | Kindred at Home | \$2.8 |
| Apollo Global Management | Texas Digestive Disease Consultants | \$2.2 |
| Becton, Dickinson | Parata | \$1.5 |
| Walgreens Boots | Shields Specialty Pharmacy | \$1.4 |
| General Atlantic, Nautic Partners, Vistria Group | PANTHERx Rare | \$1.4 |

Q3'22 strategic and PE deal volume compared to the quarterly average in 2021

| Strategic | Private equity |
|-----------|----------------|
| 211 deals | 172 deals |
| -31% | -44% |

Consolidated U.S. healthcare activity



About the data: Data was sourced from Bloomberg, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced during each quarter. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.



Divestitures can raise cash and accelerate growth—or destroy value

Divestitures and carve-outs can help healthcare and life sciences companies create value by improving their focus on core businesses or shedding underperforming units. Most successful sellers present a spin-off to potential buyers as a “business in a box”—a stand-alone entity ready to thrive unencumbered by operational, managerial, or financial issues. But much of a divestment’s value can be lost if the seller doesn’t properly plan or execute the transaction.

Companies divest businesses for many reasons: to change strategic focus, improve valuation, or set up a different control structure and reduce bureaucracy. Takeda, for example, has been divesting \$10 billion in noncore businesses to pursue long-term growth options such as gastroenterology and rare diseases. The company has been carving out consumer businesses and making acquisitions in specialty pharma development, contract development, manufacturing, and research.

While a carve-out can be less expensive to buy and easier to close, if the deal is not well executed, both parties can lose out on potential value in “dis-synergies” such as compromised customer value propositions and reduced vendor negotiating power because of parent-company contract terms.

In our experience, sellers face challenges in five main categories:

| Challenge | Root cause | Impact |
|--|--|---|
| 01 Vague scope | Buyers and/or sellers treat the carve-out as they would a general M&A transaction, despite increased complexity. Some define the deal parameters too loosely, for example. | <ul style="list-style-type: none"> • Misdirected efforts in the planning phase lead to challenges in execution, increasing costs and delays • Inability to define or set up comprehensive product and financial flows |
| 02 Multiple stakeholders | Central management isn’t aligned on objectives. | <ul style="list-style-type: none"> • Competing priorities between RemainCo and CarveCo • Duplicated carve-out activities and misdirected resources |
| 03 Limited resources | CarveCo employees supporting carve-out activities must also manage their day-to-day responsibilities. | <ul style="list-style-type: none"> • Reduced employee morale • Departure of key CarveCo personnel |
| 04 Entanglement identification and management | RemainCo and/or CarveCo misrepresentation or misunderstanding of entanglements | <ul style="list-style-type: none"> • Incorrect lead times driven by lack of detailed information • Extended and expanded transaction services agreements (TSAs) • Unidentified dis-synergies |
| 05 Structure of shared services via global delivery model | High CarveCo dependency on RemainCo across target operating model dimensions ² for all functions | <ul style="list-style-type: none"> • Risk of recreating the old model rather than developing the best structure for CarveCo |

¹ CarveCo is the subsidiary, division or other part of a larger business enterprise being sold or stood up as its own entity.

² Such as process, technology, assets, contracts, and people

Six actions that help address challenges:

| Action | Description |
|---|--|
| 01 Don't dump toxic assets | RemainCo must create a business that can show a clear path to value |
| 02 Sell what people want to buy | Analyze the buyer pool before developing any carve-out plan. Look throughout the healthcare industry landscape and use gaps to build the rationale for the deal |
| 03 Define "no regrets" moves | Identify initial decisions that can be made "without regret" that define the transaction's direction and scope |
| 04 Craft the blueprint | Clarify a vision for CarveCo and develop the blueprint to reach it. Creating a central, cohesive source for operating-model components will help all stakeholders get behind one shared vision |
| 05 Do the deal in stages | Take a phased approach that manages rollout pressure while allowing the team to build momentum and learn from initial deployments, and to adapt for more complex execution plans later |
| 06 Develop shared services via global delivery model | Establish a shared and centralized services structure for CarveCo that aligns with CarveCo's strategy |



Simon Hodson

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Simon Hodson on healthcare partnerships:

In the economic downturn, more HC companies are looking to forge partnerships or merge to grow service lines without making huge investments.

Outlook

Caution will reign well into 2023

The experts in KPMG Economics expect a mild recession that starts in Q4'22 and is more abrupt and deeper than previously forecast, as the U.S. Federal Reserve continues to raise rates over the next two quarters. We now expect the Fed to raise rates by 0.75 percentage points in both November and December.

Prices remain stubbornly high, from food and shelter to energy and healthcare.

Companies are paying more for supplies and talent, particularly clinical talent, which is squeezing margins, reducing capital for investment, and limiting companies' ability to expand operations. We expect many HC companies to raise prices as labor shortages and supply chain challenges persist. More patients may postpone elective procedures, particularly if COVID-19 infections rise in the winter months.

Providers with stronger balance sheets are gaining ground with patients by investing in patient engagement and satisfaction-enhancing offerings and technologies. The gap between "haves" and "have-nots" will likely expand.

Appealing targets should continue to entice players looking to gain vital capabilities or enter new growth areas. We expect many acquirers to focus on the basics, including revenue cycle management, value-based care, and the advanced analytics to make it all work. Sellers will include financial sponsors, companies making strategic divestitures, and public entities.

We expect hospital systems to see few suitors, particularly targets with high "rollover risk"—large outstanding debts that will need to be financed at higher rates. In addition, the exceptionally strong dollar could make some overseas targets look like bargains, but economic and political turmoil in those markets could last for years, forcing acquirers to work much harder to create value.

Agreeing on deal terms could be more difficult in some cases: most acquirers will be more selective and have less leverage through 2023 as interest rates climb, and some sellers may be reluctant to accept valuations that are considerably lower than their peaks in 2021.

Key considerations as we look ahead

Many deal-makers will need to shift gears in this environment:

- 1 Capital availability** will determine what deals can get done. Sellers should rank buyers based at least in part on their ability to close.
- 2 Deal speed** will matter more than ever in today's fast-moving economic environment.
- 3 A compelling story**, including the ability to stand alone, will help a typical seller attract the right suitors and negotiate from a position of strength.



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How we can help you

KPMG helps clients overcome deal obstacles by taking a truly integrated approach to delivering value, using its depth of knowledge in the healthcare industry, data-supported and tools-led insights, and full M&A capabilities across the deal lifecycle.

With a healthcare specialization, our teams bring both transactional and operational experience, delivering rapid results and creating value.

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