PitchBook

The Healthcare PE Investment Landscape

Assessing key investment characteristics, capital flows, and performance in a burgeoning space

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Key takeaways

- **PE investment in healthcare has outpaced that of the overall PE market.** Investors still have the global financial crisis (GFC) fresh in their minds, and healthcare's outperformance in the face of the COVID-19 pandemic has led to increased deal activity. Furthermore, trends both specific to healthcare and the overall PE market have been tailwinds for the industry.

- **Healthcare funds outperform non-healthcare funds in terms of both IRR and TVPI metrics.** However, the high TVPI figures also translate into returns at exit rather than immediate capital. Thus, healthcare investments may have differing levels of attractiveness depending on the goals of the LP.

- **While the number of investment strategies across healthcare subsectors is vast, the overwhelming majority of healthcare deals are done in the providers & services subsector.** GPs have been rolling up retail clinics in this space for a few years now, and many of these PE-backed entities have scaled, forcing GPs to look beyond consolidation for value creation.

Published on September 25, 2020

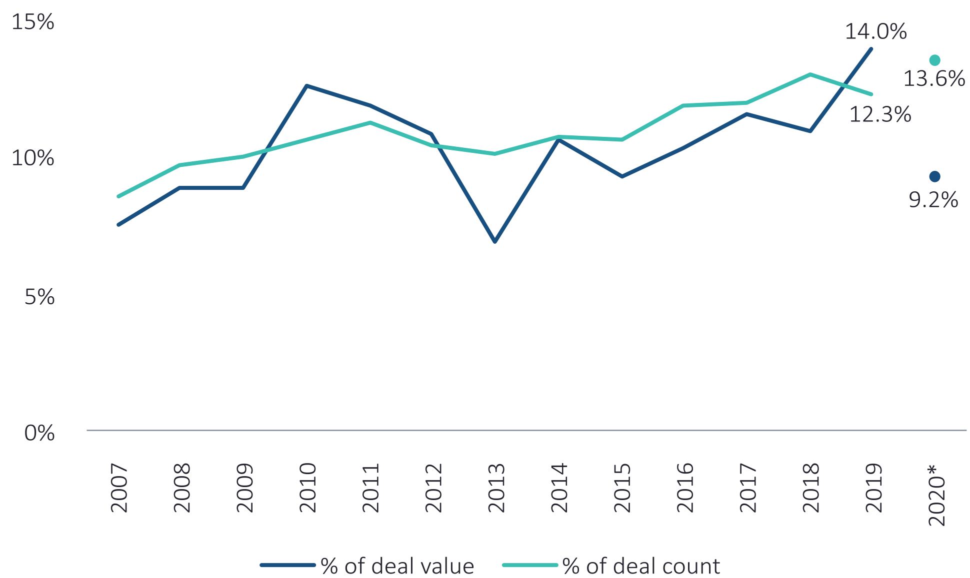
A note on methodology:

Healthcare is generally portrayed as a sector comprised of two disparate industry groups: healthcare equipment & services and pharmaceuticals, biotechnology & life sciences. Each of these groups encompasses three industries. Healthcare equipment & services includes healthcare equipment & supplies, healthcare providers & services, and healthcare technology (healthtech). The pharmaceuticals, biotechnology & life sciences space consists of biotechnology, pharmaceuticals, and life sciences tools & services. While this delineation conforms to that of the Global Industry Classification Standard (GICS), it is not the only method used to classify companies in the healthcare sector. Healthtech is often considered a standalone industry group, with all healthcare technological companies included under that umbrella. In addition, there is frequent overlap between each segment, which can make pinning down a specific group an arduous task. However, in this note, we will use the GICS method. which differs slightly from the nomenclature used in the PitchBook Platform. Furthermore, for simplicity, we have grouped pharmaceuticals and biotechnology (pharma & biotech) together.

Introduction

PE investing in healthcare businesses has outpaced broader PE deal activity since 2009 as the industry seeks to capitalize on the aging global population, a global rise in per capita healthcare spending, and several other compelling trends. Even before the onset of the COVID-19 pandemic, the PE industry was facing pressures from high fees despite diminishing returns, and investors were searching for new sources of alpha in a more competitive, high multiple, and low-growth environment. Healthcare investors are banking on global secular tailwinds, increased prevalence of chronic disease, and the growth of the middle class, and see healthcare as a rare sector with long-term outperformance potential. Moreover, industry trends such as GPs increasingly executing growth equity deals and LP demand for more ESG-friendly investment funds have also altered the private investment landscape. These factors have helped PE investments in the healthcare sector continue to proliferate. LPs are amenable to healthcare funds as the sector remained robust throughout the global financial crisis (GFC), and because healthcare investments generally fit within ESG parameters.

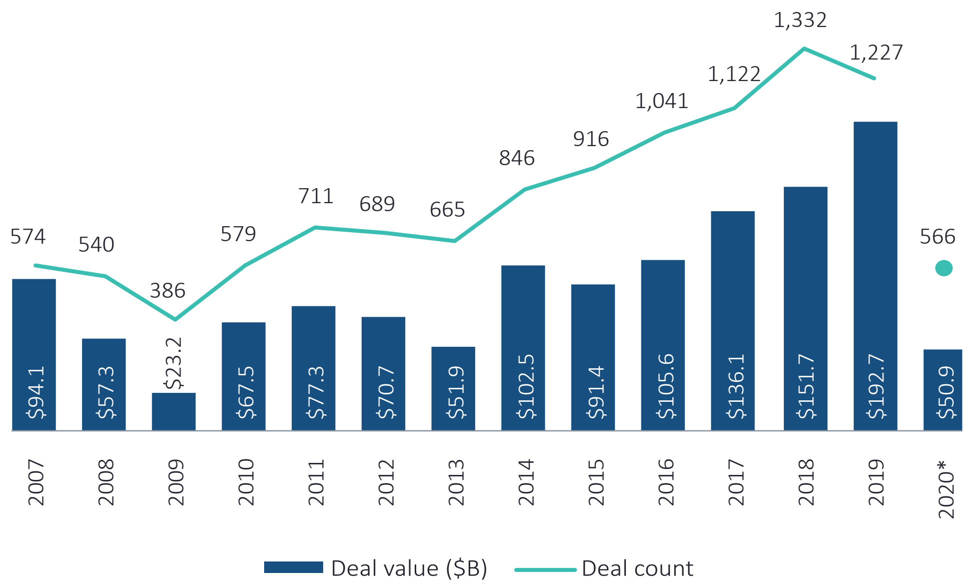
Healthcare proportion of overall PE activity



Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

PE activity in the healthcare space is by no means a recent phenomenon. PE healthcare investment has steadily increased over the last 20 years, and investors now play an integral part of the healthcare ecosystem. In 2019, PE firms invested over $190 billion across 1,227 healthcare deals. The sector accounts for a large portion of the broader PE market, with healthcare investment representing 14.0% of deal value, up from 8.9% in 2009. In the 1990s, PE shops rarely specifically targeted healthcare deals, whereas currently most generalist GPs are interested in the space, and dozens of PE firms focus solely on healthcare. With firms such as Blackstone, Bain, and KKR upping their focus on the area in recent years, this trend does not seem set to subside.

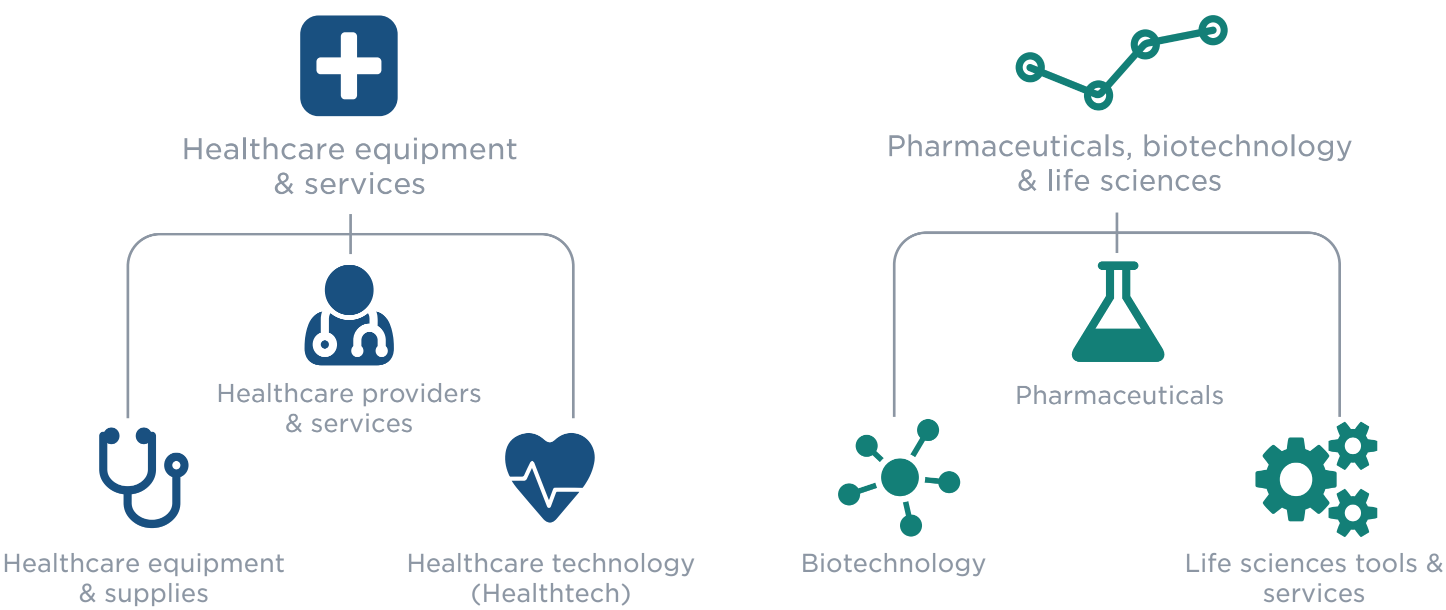
Healthcare PE deal activity



Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

In this note, we provide an overview of PE investment in the healthcare space, first by delineating the different areas of healthcare in which PE firms are active, and then by describing investment preferences in each of the spaces. We finally go on to examine trends in healthcare PE, fund performance, and notable GP activity.

Healthcare industry breakdown



Notable fund closings in healthcare

Fund name	Fund type	Fund size ($M)	Close date	Fund info
TPG Healthcare Partners	Buyout	$2,700.0	July 2, 2019	The healthcare fund closed in tandem with TPG's flagship buyout fund TPG Partners VIII, which closed with $11.2 billion raised. The healthcare fund will invest along with the flagship fund in healthcare deals.
EW Healthcare Partners Fund 2	PE growth/ expansion	$746.3	August 22, 2019	EW Healthcare Partners Fund 2 will invest in healthcare companies in the pharmaceutical, medical device, diagnostics, and technology-enabled services sectors in the United States and Europe.
Revelstoke Capital Partners Fund II	Buyout	$ 714.0	December 5, 2019	Revelstoke Capital Partners Fund II closed in tandem with Revelstoke Single Asset Fund I, which closed with $660 million raised. Concurrently with the closing of RSAF I, the funds acquired Upstream Rehabilitation, a provider of outpatient physical therapy services. Revelstoke invests $10 to $250 million in companies with a minimum of $5 million in EBITDA.
WindRose Health Investors V	Buyout	$ 705.0	January 7, 2019	Windrose V closed at its fundraising cap. The fund is much bigger than the 2014 vintage Windrose IV, which closed at $365 million. Windrose makes investments in companies with enterprise values between $25 and $300 million.
DW Healthcare Partners V	Buyout	$610.0	July 23, 2019	The fund will target investments in approximately 10 North American healthcare companies with control or near-control positions. The average investment size will be $40 million to $45 million, but could vary between $20 million and $60 million.

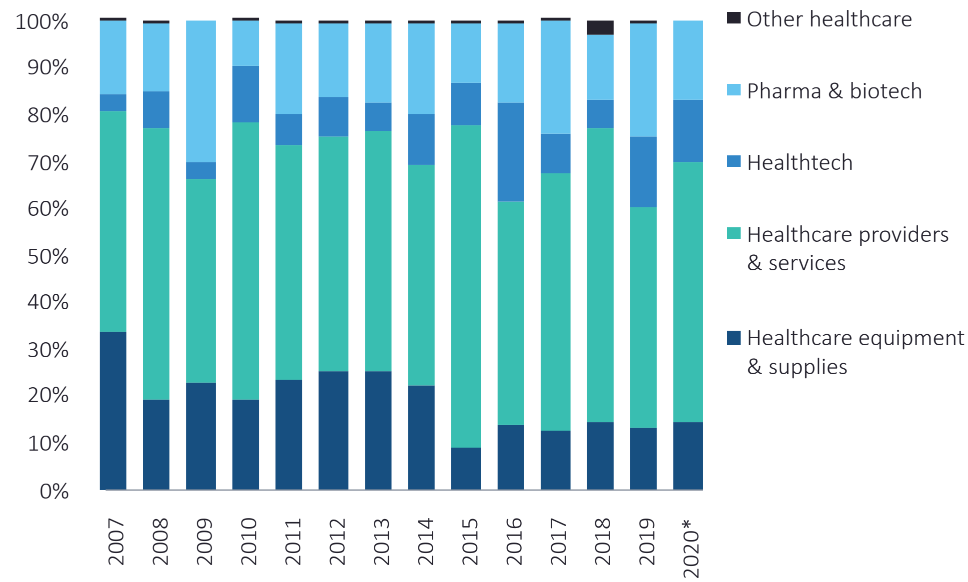
Source: PitchBook | **Geography:** North America & Europe

Notable open healthcare funds

Fund name	Fund type	Fund size ($M)*	Open date	Location
Waud Capital Partners V	Buyout	$910.9	April 24, 2019	Chicago
Avista Capital Partners V	Buyout	$619.3	April 26, 2019	New York
Bain Capital Double Impact Fund II	Buyout	$596.3	March 10, 2020	Boston
Beecken Petty O'Keefe & Company Fund V	Buyout	$400.0	December 22, 2017	Chicago
Water Street Healthcare Partners IV S	Buyout	$345.0	February 4, 2020	Chicago

Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

Healthcare PE deals ($) by sector



Source: PitchBook | **Geography:** North America & Europe
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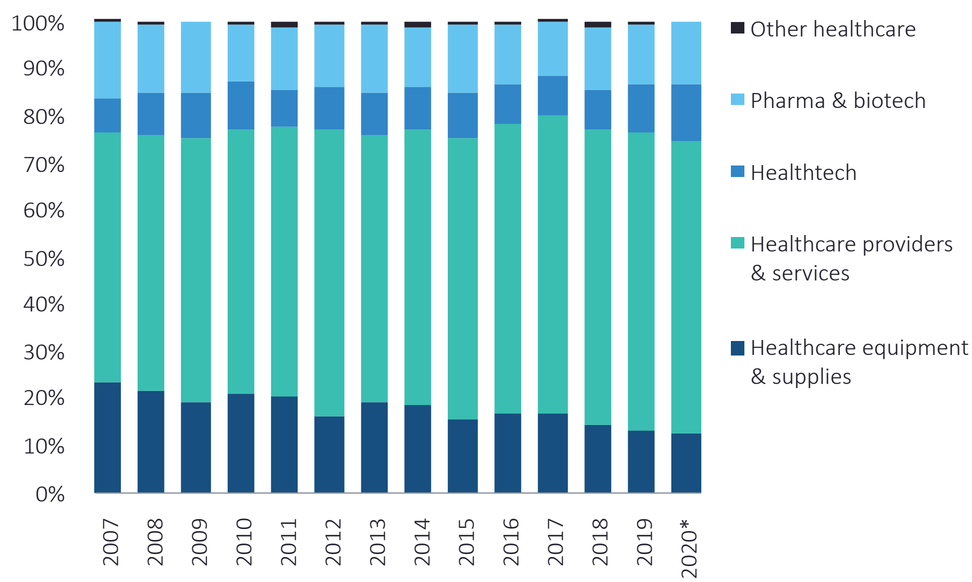
Healthcare PE deals (#) by sector



Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

Investment landscape

Healthcare providers & services

Healthcare providers & services is the largest area for PE investment in the overall healthcare sector. Retail healthcare assets comprise a large proportion of this subsector, and the overall area saw more capital invested and more deals than any other subsector in the healthcare space in 2019—totaling $90.2 billion in PE investment over 761 deals. This is compared to the $99.9 billion of PE investment over 431 deals that went into all other healthcare subsectors combined. PE shops have been keen on retail healthcare due to the subsector's highly fragmented nature, attractive margin profiles, and strong growth characteristics. According to Bain, standalone retail healthcare clinics have EBITDA margins around 25% (which can go as high as 45%), and retail healthcare revenue has been growing steadily around 3% to 4% annually as of 2018.[1] Also, many of the companies in this subsector rely heavily on consumer choice, which translates to more patients paying out-of-pocket and less insurance reimbursement risk.

Due to the retail healthcare's highly fragmented nature, GPs have been busy rolling up dermatology, dental, gastrointestinal, ophthalmologist and veterinary clinics (among others). In the past, the investment strategy when acquiring these assets was relatively straightforward and generally involved consolidating mom-and-pop businesses and harvesting the subsequent multiple arbitrage that comes with stability and scale. However, some of these PE-backed entities have since scaled and thus value creation must now also come from cutting costs, increases in same-store sales, and potentially financial engineering. Lastly, success largely depends on the physicians and clinicians involved in the company—players who are motivated not only by profit but also by performance as measured by patient outcomes. As such, improvements in quality of care and patient experience are also key components to success in the healthcare providers & services sector.

GPs have also moved into behavioral health and hospice/home care for similar reasons. An increasing awareness of mental health and addiction has been a tailwind buoying behavioral healthcare investment. In a recent string of deals in March, April, and May of 2019, Silver Oak Services Partners acquired a behavioral health treatment facility each month. Silver Oak has also been active in rolling up physical rehabilitation clinics. Given the vast fragmentation of the healthcare industry, we anticipate investment continuing into untapped areas ripe for consolidation.

Recent healthcare providers & services deals

Company name	Investor name	Deal value	(Sub)sector	Company HQ
Alliance Animal Health	LightBay Capital	Undisclosed	Hospitals/inpatient services	New York
DentalCorp Health Service	L Catteron	$1.3 billion	Clinics/outpatient services	Toronto
Capital Vision Services	Goldman Sachs Merchant Bank	$2.7 billion	Clinics/outpatient services	Vienna, VA

Source: PitchBook | **Geography:** North America
*As of August 13, 2020

1: "What's Behind the Surge in Retail Healthcare Deals?" Bain & Company, May 9, 2018.

Healthcare equipment & supplies

Healthcare equipment & supplies, also known as the medical technology (medtech) sector, commands a fair amount of corporate interest, often relegating PE firms to the sidelines or consigning them to competing for smaller assets. In 2019, the space saw $24.3 billion in PE investment across 146 deals. The medtech subsector consists of instruments, apparatuses, and machines used in the diagnosis, treatment, or prevention of illness, or for detecting, measuring, restoring, or modifying the body for some health purpose. Companies that manufacture pacemakers, surgical gloves, and dental equipment are included in the subsector. The value of the PE investments is lower than pre-GFC levels, an indication that financial sponsor activity has moved away from medtech and toward healthcare providers & services and healthtech. However, PE investors, such as Clayton Dubilier & Rice, can still carve out niches in specific areas of the sector, such as consumer-facing medtech. The financial sponsor was part of the consortium which took SmileDirect Club public in 2019, and it also carved out aesthetic treatment developer Cynosure from Hologic (NASDAQ: HOLX) that same year. While corporate acquirers make for hefty competition at the top end of the medtech subsector, those same corporates are also interested in buying PE-backed medtech companies. Smaller category-leading companies are ripe for PE investment in the space, allowing GPs to consolidate these companies and exit to an acquisitive corporate with strategic interests.

Medtech firms can also capitalize on overarching healthcare trends, such as the rising global middle class and subsequent increased medical spending per capita. For example, Ottobock, a developer of prosthetic limbs, sold a 20% stake to EQT for €630 million in a 2017 growth equity deal. Overall, corporates are heavily interested in the space, which gives PE shops a double-edged sword. On one hand, they face heavy competition from acquirers with deep pockets that often push them to the fringe areas of medtech. However, those same competitors make for great purchasers come time to exit. We see PE activity in the space holding steady in the future.

Recent healthcare equipment & supplies deals

Company name	Investor name	Deal value	(Sub)sector	Company HQ
Orchid Orthopedic Solutions	Nordic Capital	$993.0 million	Surgical devices	Holt, MI
Surgical Specialties	Aretex Capital Partners	Undisclosed	Surgical devices	Westwood, MA
Rayner Group	Phoenix Equity Partners	Undisclosed	Medical supplies	Worthing, UK

Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

Healthtech

Due to expanding digitization, healthcare technology (healthtech) has seen rapidly increasing PE deal activity, with $28.3 billion in PE invested over 124 deals in 2019. Among other areas, healthtech includes the application of cloud-based infrastructure and big data analysis within the healthcare sector and has seemingly limitless possibilities in terms of improving healthcare outcomes and patient experiences. Furthermore, the switch to value-based care is a boon to PE investment in healthcare—and specifically healthtech—because gains will come from increases in successful procedures rather than sheer number of procedures completed, placing higher importance on organization. As such, healthtech has seen interest from traditional healthcare PE funds and tech PE funds alike for a wide array of technologies in the space. In the past, most healthtech focused on electronic medical records (EMR), whereas the industry now covers everything from decision/risk analysis to outcome management, including healthcare enterprise systems which develop software for multiple portions of the healthcare space.

Given the incongruity, there is no overarching investment thesis for healthtech, and PE sponsors should analyze each healthtech company on a standalone basis. Still, we consider specific areas of healthtech more appealing than others. For instance, healthtech related to payors, such as with Bain Capital's buyout of Redcard via its portfolio company Zelis Healthcare, has seen increased PE investment focus. In addition, revenue cycle management (RCM) has emerged as a popular niche, exemplified by Ares Capital's buyout of Athenahealth.[2] We see healthtech as one of the most promising areas in healthcare. PE firms will continue to search for deals in the space given that it combines aspects of two high-growth sectors in a time when growth is scarce.

Recent healthtech deals

Company name	Investor name	Deal value	(Sub)sector	Company HQ
Netsmart Technologies	TA Associates	Undisclosed	Medical records systems	Overland Park, KS
Healthedge	Blackstone	$730.0 million	Other healthtech systems	Burlington, MA
AGS Health	Baring Private Equity Asia	Undisclosed	Medical records systems	Newark, NJ

Source: PitchBook | **Geography:** North America
*As of August 13, 2020

2: Athenahealth is an enterprise systems company, with capabilities which include RCM but also extend to electronic health recording, patient engagement, population health management, and so on.

Pharma & biotech

Although most private market investment in pharma & biotech has been done by VC firms, investors are beginning to deploy PE with growth equity deals. Given the high risk-reward profile and binary outcomes of many pharma & biotech investments, PE shops tend to focus on companies that deal with branded drugs and have low pipeline and R&D risk. PE shops often like to focus on more consumer-heavy areas such as skincare due to less exposure to pricing pressure—for example, in the EQT-led buyout of Galderma. Galderma's portfolio includes Proactiv and Cetaphil, skincare products which require a lot of consumer branding, and this appeals to PE shops as building up consumer-branded products is often a staple of the PE playbook. However, some specialized PE firms are willing to take on riskier investments. In 2019, Blackstone—through its life sciences unit—partnered with Swiss pharmaceutical company Novartis in 2019 to create Anthos Therapeutics, a biotechnology company that develops therapies for high-risk cardiovascular patient populations. That November, KKR created Gamma Biosciences, a life sciences investment tools platform. While large deals for branded drugs made their way to the top of the pharma & biotech deal list, acquisitions and partnerships with generic drug manufacturers also occurred. We see generic drugs as a prime area for PE due to high levels of fragmentation. Also, generic drug investment opportunities can provide financial sponsors with a counter-cyclical investment strategy. Going forward, we anticipate financial sponsors will become comfortable with the risks inherent in pharma & biotech investment, leading to increased investment in the space.

Recent pharma & biotech deals

Company name	Investor name	Deal value	(Sub)sector	Company HQ
Cambrex	Permira	$2.4 billion	Pharmaceuticals	East Rutherford, NJ
Biocon Biologics	True North	$75.2 million	Drug discovery	Bangalore, India
Quotient Sciences	Permira	$755.8 million	Drug discovery	Nottingham, UK

Source: PitchBook | **Geography:** Global
*As of August 13, 2020

Life sciences tools & services

In a similar vein to healthtech, PE investment in companies and technologies focused on supporting drug development and commercialization have also continued to flourish. Some companies in this subsector support the drug product life cycle, such as Piramal Pharma Solutions. The company—a contract development and manufacturing organization (CDMO) offering end-to-end services to bring a drug to market—sold a 20.0% equity stake to The Carlyle Group for $490.0 million in a June 2020 growth equity deal.

Other companies support the drug lifecycle from a technological standpoint. For example, eResearch Technologies provides health outcomes research services to biopharmaceutical sponsors and contract research organizations (CROs); the company was bought out in January of 2020 by Ares Capital and Astorg. We see continued investor interest in companies supplying technology and services to those in the process of bringing drugs to market, along with PE enthusiasm for high performing CDMOs and CROs with the potential to become category leaders.

Recent life sciences tools & services deals

Company name	Investor name	Deal value	(Sub)sector	Company HQ
ArisGlobal	Nordic Capital	$700.0 million	Enterprise systems	Coral Gables, FL
Tripharm Services	Madison Dearborn Partners	Undisclosed	Other pharmaceutical	Morrisville, NC
Ardena	GHO Capital	Undisclosed	Pharmaceuticals	Belgium

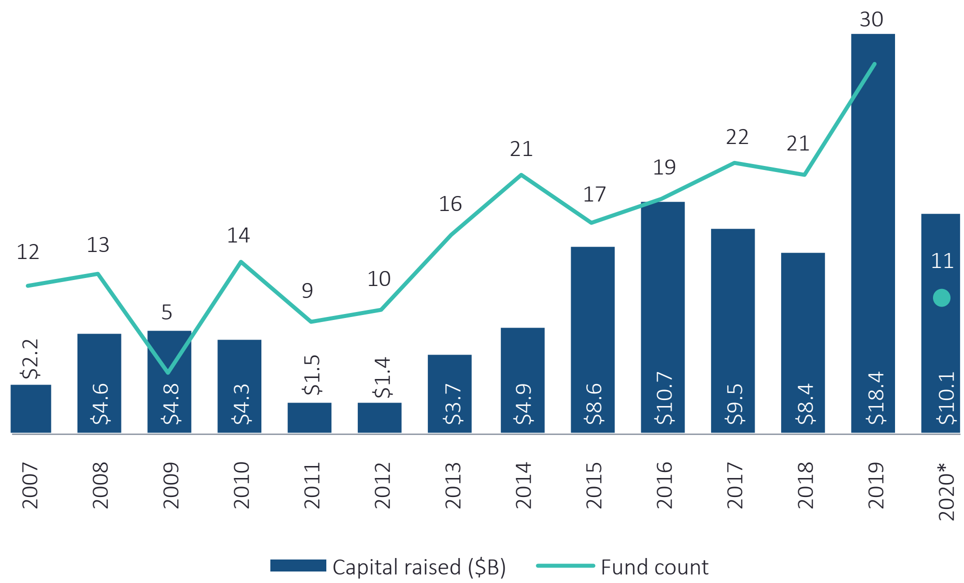
Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

Healthcare reform

Healthcare reforms could come about after the November 2020 elections and present various risks and opportunities for healthcare investors. The main possibilities of federal level reform include: a federal single-payer option replacing private healthcare, private insurance with a buy-in option, or a total repeal of the Affordable Care Act (ACA). The single-payer option would eliminate private insurance, and providers would most likely see a decline in pricing and a potential increase in patients. The buy-in option could mean higher coverage for providers, depending on the fine print in legislation. A recall of the ACA would most likely lead to lower volumes of patients. These changes would mainly affect payers and providers. The reforms could lead to positive or negative outcomes for medtech and healthtech, depending on the content in the legislation. On the other hand, drug pricing reform would more likely affect the pharma & biotech sector, though a single-payer option would presumably lead to the federal government setting lower drug prices overall. The possibilities within each potential drug pricing reform solution yields varied outcomes, making it difficult to predict a clear result for the pharma & biotech sector in this regard.

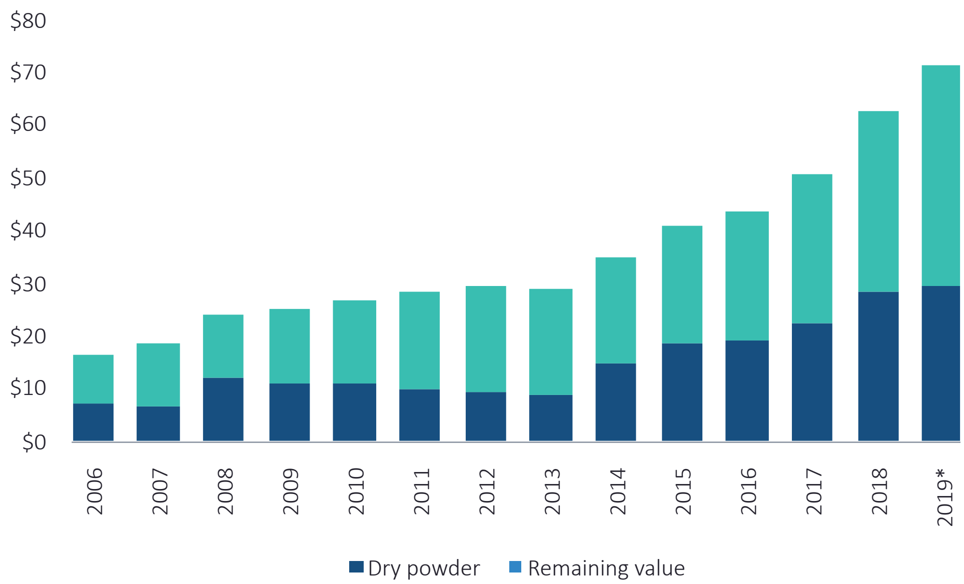
Capital availability

Healthcare PE fundraising activity



Source: PitchBook | **Geography:** North America & Europe
*As of June 26, 2020

Healthcare PE investors' AUM ($B)



Source: PitchBook | **Geography:** North America & Europe
*As of December 31, 2019

Due to the secular tailwinds of healthcare, and that the sector's resiliency in the face of the GFC remains fresh in the minds of LPs, GPs have continued to raise healthcare funds in record numbers. 2019 saw $18.4 billion raised over 30 PE funds, a sizable increase from the $8.4 billion over 21 funds in 2018. As of 2019, the total PE dry powder in the healthcare space reached $29.2 billion, up from $28.5 billion in 2018. In addition, the healthcare sector has remained resilient more recently in the face of the COVID-19 pandemic, and the MSCI World Health Care Index has trounced the MSCI World Index since the onset of the pandemic in early 2020.[3] Given increased interest healthcare and a steady rise in PE deal activity, we expect to see continued levels of robust fundraising for healthcare-focused funds.

Top PE investors in healthcare by deal count (since 2007)

Investor name	Investor HQ	Deal count	Deal value ($B)
Audax Group	Boston	215	$2.9
Waud Capital Partners	Chicago	121	$1.2
Welsh, Carson, Anderson & Stowe	New York	118	$14.8
Shore Capital Partners	Chicago	106	$0.1
Summit Partners	Boston	105	$9.7
Kohlberg Kravis Roberts	New York	90	$42.9
Linden Capital Partners	Chicago	82	$2.1
Webster Equity Partners	Waltham, MA	82	$0.2
Water Street Healthcare Partners	Chicago	79	$2.4
ABRY Partners	Boston	78	$0.8

Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

Top PE investors in healthcare by deal value (since 2007)

Investor name	Investor HQ	Deal count	Deal value ($B)
AlpInvest Partners	Amsterdam	77	$43.5
Kohlberg Kravis Roberts	New York	90	$42.9
TPG Capital	Fort Worth, TX	76	$31.6
Canada Pension Plan Investment Board	Toronto	29	$31.0
Cinven	London	36	$28.2
Kensington Capital Partners	Toronto	1	$26.4
The Blackstone Group	New York	55	$26.2
The Carlyle Group	Washington, DC	62	$25.9
Leonard Green & Partners	Los Angeles	35	$25.1
Bain Capital	Boston	52	$23.6

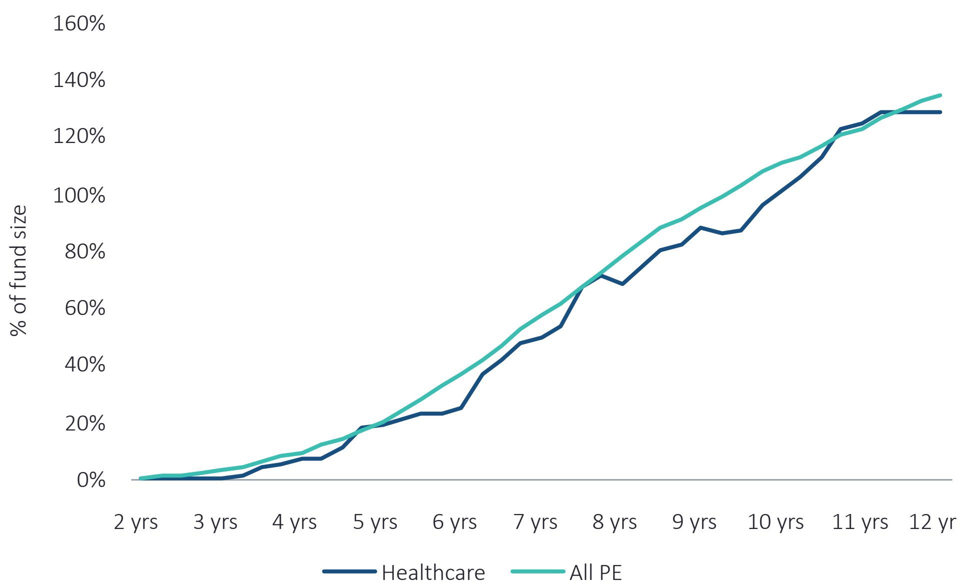
Source: PitchBook | **Geography:** North America & Europe
*As of August 13, 2020

3: "Investing in Health Care Post Covid-19, " Janus Henderson Group PLC, Andy Acker, CFA, June 2020.

Cash flows

While healthcare-focused funds have similar contribution profiles to non-healthcare PE funds, healthcare funds' distributions lag the broader market. We notice that it takes about a year longer for healthcare funds to begin distributing money back to LPs compared to overall PE funds. Furthermore, healthcare funds fall behind non-healthcare PE funds especially at the 6- and 10-year intervals. At six years, healthcare funds have a median distribution of 25.0% of committed capital, compared to non-healthcare of PE at 36.9%. At the 10-year mark, the median healthcare fund has distributed 101.3% of committed capital compared to 110.4% for non-healthcare PE funds. However, some of this lag is expected. Many healthcare funds are involved in rollups in the healthcare providers & services subsector, where the PE strategy involves combining retail healthcare clinics. The rollup strategy is a version of the buy-and-build strategy and execution can take longer than other strategies used by non-healthcare PE funds.

Median healthcare PE cumulative distributions compared to overall PE

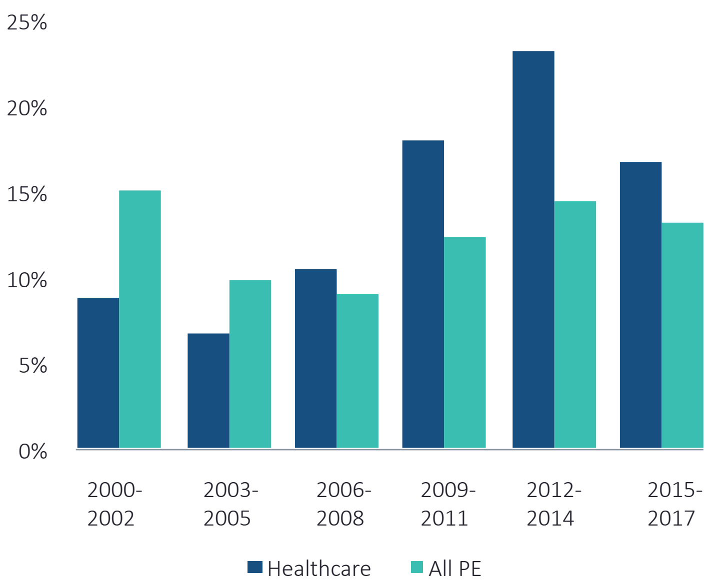


Source: PitchBook | **Geography:** Global

Performance

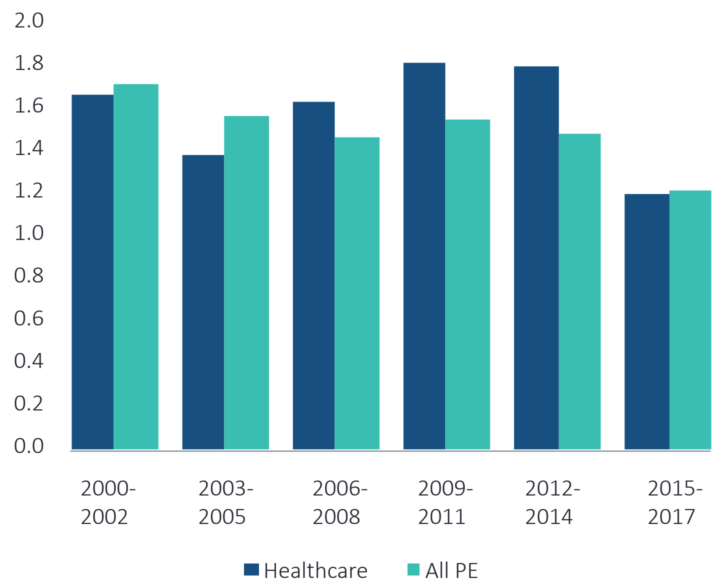
While healthcare funds are by no means a monolith, when we break out performance figures into buckets, we see that healthcare funds as a group have generally outperformed non-healthcare PE funds in more recent vintages. In terms of net IRRs, healthcare funds have increasingly beat out non-healthcare PE funds by a greater amount since the 2006-2008 vintage bucket. We also notice that net IRRs have been rising across the board for all PE funds (healthcare included), though much of the value in more recent vintages is still unrealized. In terms of TVPI, healthcare funds have outperformed the rest of PE in three out of four vintage groups since 2006. Notably, returns—in terms of IRR—were the highest for healthcare funds in the five years following the GFC, when entry prices tended to be lower and there were still many years of economic expansion ahead. Although TVPI levels are higher for healthcare PE funds, distributions lag non-healthcare PE funds. This leads to a situation where healthcare funds may produce higher returns down the line, though lower levels of near-term capital returns. LPs may find this situation enticing or unattractive based on their preferences. Given limited sample sizes, with some even in the single digits for certain vintage groups, we caution that these numbers should be taken with a grain of salt.

Median IRR by vintage year cohort



Source: PitchBook | **Geography:** Global
As of December 31, 2019
Note: Low sample sizes for certain vintage cohorts

Median TVPI by vintage year cohort



Source: PitchBook | **Geography:** Global
As of December 31, 2019
Note: Low sample sizes for certain vintage cohorts

Conclusion

The healthcare industry has many potential avenues for PE allocators and direct investors alike. Current PE trends and resilience in the face of the GFC and the current pandemic-related crisis have only increased the prominence of the sector. Furthermore, given the recent outperformance by healthcare funds compared to non-healthcare funds, we believe more and larger healthcare funds will continue garnering interest in the near future. Going forward, we hope to follow up this note with a deeper dive into one or more subsectors and the prominent investment strategies used in each.