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INDUSTRY RESEARCH

Takeaways From the 2024 Healthcare Capital Markets & Innovation Summit

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Key takeaways

- The dealmaking environment continues to be marked by risk aversion and (with a few exceptions) buyer pricing discipline. A handful of platform deals publicized in the past month provide some encouragement, but the recovery in deal activity will be slow and moderate.
- Regulatory scrutiny of PE continues to intensify, particularly at the state level. Recent legislative action in California and Oregon, as well as the increasingly bipartisan nature of congressional interest in PE's role in healthcare, underscores the need for intensive due diligence and proactive engagement when investing in healthcare providers.
- Dental and veterinary, while nowhere near "hot," are seeing some continued investor interest.
- Although add-on valuations are down slightly, medspa remains competitive, with new players quietly entering the arena.
- Lower-middle-market firms continue to play out healthcare IT theses but, as we have written previously, must constantly wrestle with unrealistic valuation expectations on the part of sellers.
- There is a disconnect between the dire need for greater provision of high-acuity mental health treatment and the unsustainability of many inpatient and residential business models.
- The Ohio healthcare community is waiting for further news of General Catalyst's Summa Health acquisition with a mix of optimism (what might this do for the region's budding healthtech startup economy?) and skepticism (Summa will require considerable operational muscle to transform into a model of value-based care integration).
- Secondary innovation ecosystems such as Columbus, Ohio represent fertile ground for proprietary deal sourcing, but early-stage founders in these ecosystems need additional support commercializing, professionalizing, and accessing capital.

Introduction

Now in its fourth year, the Healthcare Capital Markets & Innovation Summit (HCMIS) in Columbus, Ohio is emerging as a high-value calendar fixture for lower-middle-market dealmakers in the Midwest. Presented by Lawrence, Evans & Co. and held June 5-6, the event attracted roughly 300 attendees comprising early-stage founders seeking capital, VC- and PE-ecosystem players, lenders, bankers, and capital providers. PitchBook presented two talks on the state of healthcare PE investing and the sector's outlook over the coming years. The two-day schedule of content and networking events culminated in a sun-soaked afternoon outing to the PGA Tour.

Although Columbus might seem off the beaten path, HCMIS draws a collection of senior, national-practice attendees who happen to be Ohio-based as well as participants from Chicago, Nashville, and further afield in many cases. The conference has also come on to the radar of middle-market PE firms seeking a proprietary deal-sourcing edge. PE sponsors represented included Avesi Partners, Eir Partners, Excellere Partners, McCarthy Capital, RC Capital, Revelstoke Capital Partners, and Stonehenge Capital.

Deal outlook

Although the cost and availability of capital has improved since 2023, it is still difficult to make deal math work in relation to current seller pricing expectations.

We have described the current PE dealmaking environment extensively in our quarterly healthcare services report and recent conference recap notes. Briefly: although the cost and availability of capital has improved since 2023 to around SOFR+525 on up to 5x EBITDA for an LBO financed with private credit, it is still difficult to make deal math work in relation to current seller pricing expectations. Due diligence is extensive; buyers are risk averse. The process for Webster-backed clinical trial site manager CenExcel, which nearly scored a buyer at around a $1.3 billion valuation, reportedly broke in May.[1]

Nevertheless, we have seen positive signs as of late. The creation of pharma services platforms is accelerating, with several deals announced in the past month, including InTandem Capital Partners' acquisition of Adams Clinical, The Riverside Company's acquisition of CRIO, and Arsenal Capital Partners' acquisition of Endpoint Clinical and Fortrea Patient Access. Additionally, two large applied behavior analysis (ABA) deals, Frazier's in-progress sale of Caravel Autism Health to GTCR and InTandem's announced sale of Behavioral Innovations to Tenex Capital Management,[2, 3] signal the return of a once red-hot market that shuttered in 2022 and 2023 in the wake of the Center for Autism and Related Disorders' bankruptcy. Valuations seem to have rationalized somewhat, with both platforms trading at respectable upper-teens multiples (as compared with high-twenties deals during the 2018-2021 ABA bubble). Finally, Waystar's successful IPO on June 7, 2024 notched a win not only for sponsor EQT but for the broader healthcare IT ecosystem, which features a handful of large platforms eyeing exits within the next 12-18 months.

1: "Scoop: Webster's CenExcel Process on Ice, Sources Say," Axios Pro, Aaron Weitzman, May 9, 2024.
2: "Private Equity Firm GTCR Plans to Acquire Caravel Autism Health," Behavioral Health Business, Chris Larson, May 20, 2024.
3: "Behavioral Innovations Sells to New PE Owner, Marking Biggest Deal of 2024 So Far," Behavioral Health Business, Chris Larson, May 31, 2024.

In the lower middle market, the reported pace of dealmaking is as varied as the number of active (or inactive) participants. One investor we spoke with at HCMIS has closed six platform deals in the past six months. Others are developing theses while maintaining pricing discipline—that is to say, largely not investing. And as our own data shows, healthcare specialists continue to post successful fundraises and outraise (relative to target) generalist managers. But—as a candid conversation near the seventh hole of the PGA Memorial Tournament highlighted—nearly everyone will feel more confident once they notch another exit or two. During the conference, we presented data suggesting that even when PE healthcare dealmaking does come back—slowly throughout 2024, and picking up as pricing resets in 2025 and 2026—it will remain moderate in pace for at least a few years due to knock-on effects of the current distributions lag on fundraising and, in turn, capital deployment.

A few categories of note:

- **Dental and veterinary:** In our presentation, we highlighted dental and veterinary as the two traditional physician practice management (PPM) categories seeing the most investor interest amid an overall pivot away from specialty providers. It is no coincidence that both categories involve significant cash-pay revenue, a feature many investors are gravitating toward in the current environment, and pose less regulatory/headline risk than medical specialties. While neither category is anywhere close to "hot," both are seeing continued modest add-on activity and sponsor interest in new platform creation.

- **Medspa:** Add-on valuations are down somewhat from their peak in early 2022 but are still regularly in the high single digits. We have been struck lately by the diversity of PE approaches to playing medspa and enjoyed getting to know Thurston-backed Alpha Aesthetics at the conference. Alpha is pursuing a disciplined hub-and-spoke growth strategy with a unique joint-venture model. While announced deal volume has slowed, new sponsors continue to enter the arena, including Lorient Capital, which quietly launched an Arizona-based platform earlier this year.

- **Healthcare IT:** As we recently wrote, PE healthcare IT deals have continued to stall due to a persistent valuation gap. Several investors we spoke with bemoaned the number of founder-backed healthcare IT companies still expecting to be valued on a multiple of revenue.

Regulatory risks

At each of the three healthcare PE conferences we have attended this year—McDermott Will & Emery HPE, McGuireWoods HCPE, and HCMIS—the regulatory environment has taken a successively larger portion of mindshare. We continue to see the key risks to PE healthcare investment as follows: PE-backed healthcare providers now face significant headline risk, concentrated among large-cap players but also extending to the lower middle market. This can pose serious challenges for clinician recruitment and retention, exacerbating current challenges with income repair and "second bite" models of physician compensation. It was recently reported that one-third of Ascension's affected Illinois physicians have quit after

the health system decided to outsource hospitalist staffing to Onex-backed SCA Health.[4] The PE healthcare services ecosystem is also struggling with a growing PPM exit backlog, which is in part a result of larger firms rotating away from provider deals. Finally, prominent action by the Federal Trade Commission (FTC) and other federal policymakers, while perhaps limited in its direct efficacy, is helping to embolden more aggressive action directed at PE in healthcare at the state level.

The opening speaker at HCMIS, Tommy Barletta, founder and managing partner at DC advisory firm Jones Point, highlighted several important nuances from a policy perspective. First, there will likely be a pre-election public output resulting from the three-agency "inquiry on corporate greed in healthcare" request for information launched in March, which could do further damage to the industry's reputation. Second, congressional scrutiny of PE's role in healthcare has moved from a progressive issue to a bipartisan one, with several Republicans active. Third, numerous grassroots organizations have recently emerged to oppose PE and other corporate interests in healthcare, adding to an already well-funded array of advocacy groups headed by the Service Employees International Union (SEIU).

State-level regulation poses the most material risk to PE and is likely to continue after November regardless of the election outcome.

Fourth, state-level regulation poses the most material risk to PE and is likely to continue after November regardless of the election outcome. California's Assembly Bill 3129, which is now before the state Senate's health and judiciary committees, would go further than California's existing Occupational Safety and Health Administration review requirement by giving the state's attorney general the power to grant or deny permission for any PE healthcare transaction. And Oregon's House Bill 4130, which failed to pass the state Senate but will likely be reintroduced in a subsequent session, would have effectively banned the management services organization structure (by which corporations partner with healthcare practices without violating prohibitions regarding the corporate practice of medicine) in Oregon.

Barletta's advice to dealmakers in light of these developments echoed the advice we heard from American Investment Council CEO Drew Maloney at McGuireWoods HCPE: In addition to measuring and reporting impacts on patient outcomes and cost-savings, firms should proactively engage with city and state policy makers as members of the local business community. They should also conduct due diligence on state-level political risks before making provider investments.

Quick takes

Deal sourcing in secondary markets: Meeting early-stage founders—and peppering them with market segmentation and competitor analysis questions—is one of our favorite conference activities and an easy one to indulge in at HCMIS. Startups in categories including clinical trials recruitment (OnKai), social determinants of health assessment (RE-Assist), and care navigation (CaringWire) were in attendance, seeking funding, partnerships, and network connections. Since many, if not most, lower- and core-middle-market firms aspire to differentiate via thematic and proprietary deal sourcing, seeking out budding innovation ecosystems in secondary markets can be an appealing strategy. We also met several professionals with consulting businesses

4: "Ascension Outsourcing Prompts Large Share of Hospitalists To Quit," Crain's Chicago Business, Katherine Davis, May 30, 2024.

specifically dedicated to helping local entrepreneurs commercialize, professionalize, and access capital—know-how that can be harder to come by in the Ohio ecosystem than in, say, Silicon Valley or New York.

Summa Health/General Catalyst: We could not visit Ohio without asking around about the year's most talked-about health system M&A announcement. The responses we received were reserved in sentiment: Roughly six months out from the initial deal announcement, local discussion of the deal recalls Summa's previous failed attempt to merge with Beaumont Health and still tends to be prefaced with "if."[5] Still, there are no obvious antitrust impediments, and we view the deal as likely to close. Some attendees we spoke with echoed our own concerns about the operational muscle that will be required to align various stakeholders (especially the physicians) and make Summa into a truly integrated value-based care delivery system. It is interesting to consider whether a General Catalyst-owned Summa Health will be a boon for the Midwest's budding healthtech startup scene, or whether pilots will primarily be imported from the Silicon Valley ecosystem.

The inpatient behavioral health conundrum: One engaging panel spoke about opportunities in behavioral health, with one of the key themes being the tragic mismatch between the urgent demand for inpatient psychiatric care and the often unsustainable economics of providing that care. This gap is exacerbated by staffing challenges, elevated patient complexity, and stringent prior authorization requirements.

Over the past year or so, investor interest in behavioral health has shifted markedly away from inpatient and residential models that focus on spanning the continuum of care and toward outpatient pure plays, including partial hospitalization programs and intensive outpatient programs. For instance, in eating disorder treatment, Carlyle-backed Odyssey Behavioral Healthcare,[6] Webster-backed Discovery Behavioral Health,[7] and Revelstoke-backed Monte Nido,[8] have all scaled back their residential offerings in recent months, while Optum-owned Refresh Mental Health shuttered its eating disorder services line.[9] Residential models of adolescent mental health treatment are also under intense political scrutiny.[10] We would love to see investors find innovative ways to bridge the demand-supply gap for inpatient care, perhaps taking Acadia's health system partnership model as a playbook, but given heightened headline risk for PE in healthcare, we do not expect this to materialize in the near term.

5: "Joint Statement From Beaumont Health and Summa Health Regarding Partnership Plans," Corewell Health, May 29, 2020.
6: "Odyssey, Discovery Behavioral Health Scale Back Eating Disorder Treatment Centers," Behavioral Health Business, Chris Larson, December 11, 2023.
7: "Discovery Behavioral Health Trims Residential Care To Shift Business Strategy," Behavioral Health Business, Chris Larson, January 5, 2024.
8: "Eating Disorder Treatment Company Monte Nido Cuts Over 100 Roles To Focus on Successful Markets," Behavioral Health Business, Chris Larson, May 17, 2024.
9: "Refresh Mental Health Shutters Eating Disorder Treatment Division," Behavioral Health Business, Chris Larson, January 30, 2024.
10: "Wyden Investigation Exposes Systemic Taxpayer-Funded Child Abuse and Neglect in Youth Residential Treatment Facilities," US Senate Committee on Finance, June 12, 2024.

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