KEYNOTE INTERVIEW

Creating value in healthcare

In a high-valuation environment, healthcare investors must push value creation harder than ever, says Guillaume Jabalot, director at Montagu

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Q Why is healthcare proving so popular with private equity?

There are a number of fundamental characteristics that have traditionally made healthcare attractive to private equity investors. The sector has long-term secular tailwinds including an ageing population, the rising prevalence of chronic disease and increasing incomes.

Within the Montagu portfolio, healthcare represents 40 percent of our investments. Healthcare is also generally resilient to recession, as patients' willingness to pay is high no matter the macroeconomic context.

There are also several reasons why healthcare is particularly attractive right now, relative to other sectors. A lot of other sectors have been disrupted by two years of covid lockdowns. Despite the circumstances, people continued to spend money on healthcare and technology. In that sense, the pandemic has made the fundamental attractions of the sector even stronger.

Meanwhile, as we enter a more challenging and inflationary economic environment, and private equity managers are scratching their heads thinking about where to invest in order to avoid discretionary spend and cyclicality, healthcare seems an obvious answer.

Q Presumably, the fact that it is an obvious answer means that competition is intensifying, and valuations are climbing?

I recently saw a statistic [from Bain & Company's *2022 Global Healthcare Private Equity and M&A Report*] that showed that $93 billion was raised by 358 healthcare-focused funds in 2021. That is four to five times the amount raised in 2006 when I first joined Montagu. Healthcare has also represented more than 40 percent of the investments in Montagu's three latest funds.

Whatever metric you use, private equity interest in healthcare has increased dramatically, and it's therefore no surprise that valuations have also climbed significantly in those 16 years. It's a sobering thought.

Q How can investors avoid overpaying in that environment?

If you are paying high prices for assets on the way in, then you need to drive value creation harder as well. You also need to lower execution risk around that value creation strategy.

The process behind that starts way ahead of any deal, however. On average, we have between 400 and 450 companies that we are tracking in our database, and it takes 18-24 months on average from the first meeting with management to get to the deal signing stage. With our dedicated origination team, we use that period to get to know the business outside of the time pressure of a sales process. We build a relationship with the management team, if we can, to position ourselves favourably well ahead of a sales process.

But more importantly, we develop a real understanding of the company itself – what could be improved or accelerated? Are the operational capabilities that we have as a sponsor a good match for the challenges and complexities of the business?

If the answer is yes, and if you are able to build conviction based on facts and formulate a business plan that is more ambitious than anyone else around the table, then you can pay a high price – and for the right reasons. Since 2002, we have undertaken 17 first time buyouts in the healthcare sector through this process, which emphasises the strength of our unique origination process.

Q What are some of the value creation levers that you typically employ in this sector?

With healthcare, customers are patients, and that comes with a great deal of responsibility and a heavy regulatory framework, which underpins just about every aspect of value creation. It's hard to think of a single healthcare investment where we haven't spent considerable time improving and streamlining the processes that deal with that regulatory framework. This is particularly true of carve-outs, as we experienced with RTI, where the business had previously been non-core and not received the full attention of shareholders.

Meanwhile, valuation multiples are predicated on predictability and growth, and so you also have to focus on growing the business. That might mean expanding into new geographies or developing new products. Of course, that innovation aspect is also impacted by the regulatory environment because bringing new products to market and entering new jurisdictions means gaining regulatory approvals.

> *"If you are paying high prices for assets on the way in, then you need to drive value creation harder as well"*

Taking a new drug from clinical trials to final approval takes in excess of five years, so how you manage that innovation funnel, and the time-to-market, is central to any value creation strategy. One way in which you can manage that risk is to identify customers early on who will pay for part of the development in return for some form of exclusivity.

Another important value creation lever involves establishing sales force expertise. The commercial relationships in healthcare are very long term, again due to the regulatory environment and the complexities surrounding product development.

For example, two thirds of sales at Nemera, which produces complex drug delivery systems such as insulin pens and asthma inhalers, involve customers that have been doing business with the company for more than 10 years. There are positives to that stickiness, of course, but it also brings complexity, when the aim is to drive growth.

We typically divide sales teams into two groups – those focused on cultivating existing customer relationships, and those tasked with going out and winning new clients. The teams have different key performance indicators and different ways of thinking about returns on investment. This is another aspect of value creation that is very relevant to the healthcare sector.

We can also create value through M&A, which once again needs to be thought of in the context of the regulatory environment. Tech-enablement is critical as well. Whether you are talking about a connected drug delivery device at Nemera, smart connected instruments at Intech, or IT to support the patient journey through a hospital with another of our portfolio companies Maincare, tech-enablement is impacting healthcare just as it is every other part of our lives.

Q What kinds of healthcare investment opportunities is this digitalisation likely to create in the future?

There are a number of important trends that fall under the umbrella of digitalisation. First, there is the consumerisation of healthcare, with individuals taking direct control over their health. A smart watch that monitors your heart condition, or the insulin pens that Nemera connects to smart phones that store and analyse sugar levels and compliance with diabetes treatment, are both examples of this.

Digitalisation also covers operational

efficiencies, something that has certainly been accelerated by covid. We have experienced two years where online interactions between patients and healthcare providers increased dramatically, and that has intensified demand for the digitalisation of everything from clinical trials to medical records and revenue cycle management.

In particular, the pandemic exposed weaknesses in older hospital IT systems, which were unable to communicate with one another. Selling new interoperability software has therefore become a key component of Maincare's work.

Finally, digitalisation is also supporting the shift of care from hospital to the home, given the increased need for self-use devices, video communication tools and accessible records.

Q What other mega-trends are likely to shape the healthcare opportunity set?

Other important trends include a shift away from chemicals and towards natural products. "New ageing" – whereby people are keen to live better for longer – is a prominent theme too. People want to continue to feel good and look good as they grow older, which creates opportunities in a number of sectors in which we operate. Examples in our portfolio include Arkopharma and HTL Biotechnology.

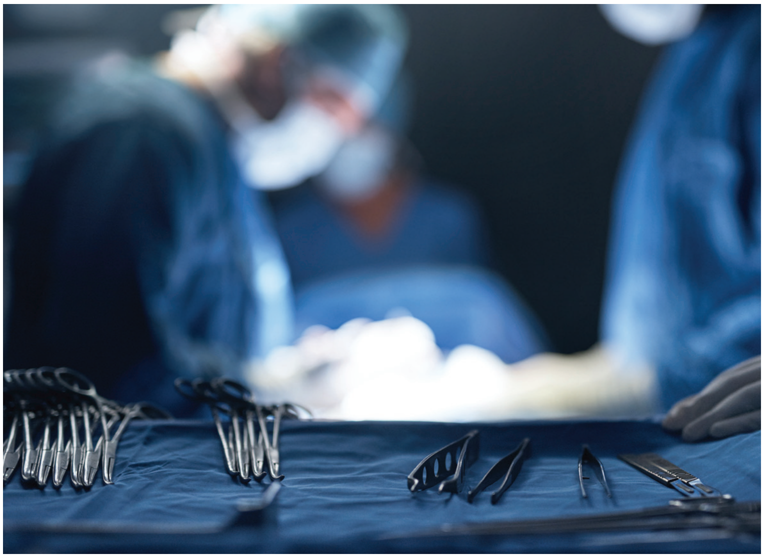
Another really exciting development is advanced precision medicine, where you start with DNA sequencing in order to prevent, diagnose and treat diseases on a personalised basis. This won't happen overnight, and again there is a regulatory overlay to this, but it is an area we are following with great interest and we are very excited about this trend.

Finally, I would point to a shortage of talent in the healthcare sector, something that was highlighted by the pandemic. Yes, we need more digitalisation, but we also need more clinicians and nurses to staff our hospitals, and that creates an education investment opportunity, which is another key sector we focus on. One example is our investment in Galileo Global Education, Europe's largest higher education group, which is growing international networks of universities, including nurse training and medical specialities.

Q What sectors have you historically chosen to invest in?

Experience counts for a great deal in healthcare, and you typically find that there is a snowball effect. Once you have completed a few deals in a certain subsector, you develop deep expertise in that space and that leads you to uncover further deals.

For example, we have completed a series of investments in the field of surgical instruments and biological implants, including Resolve, Intech and RTI Surgical. The more you invest, the more you understand the space, and the more you can help the companies you own, the more opportunities come your way. It's a virtuous circle.



Q How do you see private equity's role in global healthcare provision evolving?

The healthcare sector is stable and resilient, but it is also characterised by the need for innovation. Private equity is a very good match for that combination. You have the steady cashflows that enable you to operate with leverage for four to five years, and private equity can accelerate value creation and transformation initiatives better than any other form of ownership.

Trade buyers will typically have other priorities for their non-core businesses, while public market ownership means a fragmented shareholder base. We, however, acquire controlling interests in the businesses we back and we can fill the board with experts of the highest calibre to drive change. That is what private equity is all about.

I am therefore really excited about private equity's role in the healthcare sector, and about Montagu's role in particular. We have been investing in healthcare for the past 16 years. We are not just following the crowd. I truly believe our experience and operational expertise are an ideal fit with the investment opportunities that healthcare will continue to present. ■

Guillaume Jabalot is a director in the investment team at Montagu