AMERICAN
HEALTH LAW
ASSOCIATION

# 2023

# HEALTH CARE TRANSACTIONS

## RESOURCE GUIDE

# 2023 Outlook: Healthcare M&A

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Rising interest rates, elevated inflation, and economic uncertainty led to volatility in 2022, and many of these factors remain in place heading into 2023. While inflation appears to have peaked and is trending lower, the full impact of the rapid rise of interest rates has yet to be felt throughout the broader economy. Questions about interest rates and whether the United States economy will enter a recession will continue to linger throughout 2023.

Within the healthcare industry, valuation multiples and stock prices for public companies declined along with the broader market in 2022. Although the public markets had a difficult year, healthcare merger and acquisition (M&A) activity continued at a robust pace in 2022 (with the exception of hospital M&A, which hit multi-year lows), with deal volume increasing year-over-year compared to 2021.[1] The following charts present the enterprise value-to-EBITDA[2] multiple for the S&P 500 Health Care Sector Index (HCX)[3] and the yield on 10-year United States Treasuries[4] throughout 2022

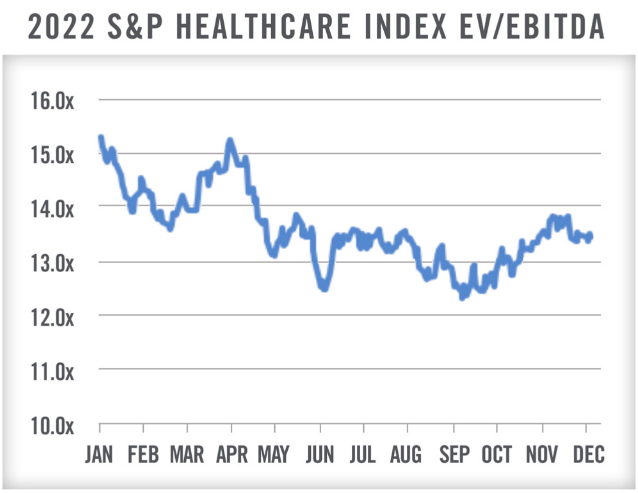


**Figure 1: 2022 S&P Healthcare Index EV/EBITDA**


**Figure 2: 2022 10-Year Treasury Yield**

## Key Questions for 2023

### Will Physician Practice Consolidation Activity Continue?

Despite the economic and financial market headwinds in 2022, healthcare M&A volume remained strong with many of the trends from past years continuing, as evidenced by physician practice transactions having been a key driver of overall healthcare deal volume. Driven primarily by private equity physician practice management (PPM) transactions, physician practices comprised 30 percent of total healthcare deal volume in the previous year.

Several factors could affect deal volume in 2023, including higher cost of capital for private equity groups, economic uncertainty, and recent Medicare reimbursement cuts that could impact budgets and lead to fewer health system acquisitions. However, many market participants expect physician practice deal volume to remain robust for a variety of reasons, such as the desire to consolidate within specific specialties and continued focus from health systems to expand their physician networks (discussed in more detail in following sections).

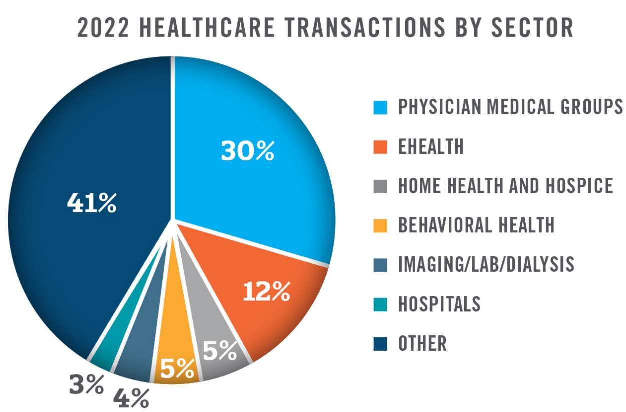


**Figure 3: 2022 Healthcare Transactions by Sector**

High levels of activity are anticipated to continue in a number of medical specialties, such as orthopedics, cardiology, and gastroenterology. Private equity activity in the orthopedics space has been growing in recent years, and their valuation multiples have increased to the low double-digit range. While a high volume of deal activity will likely continue with ophthalmology and dermatology, we expect to continue seeing large platforms transact as these specialties have been undergoing consolidation since the early 2010s. Interest in behavioral health providers is strong, based on what we hear from clients and our observations in the marketplace.

| MEDICAL SPECIALTY | TRANSACTION VOLUME | % OF TRANSACTION VOLUME |
|---|---|---|
| DENTAL | 217 | 38% |
| OTHER SPECIALIST | 108 | 19% |
| OPHTHALMOLOGY | 83 | 15% |
| ORTHOPEDICS | 34 | 6% |
| PRIMARY CARE | 34 | 6% |
| DERMATOLOGY | 34 | 6% |
| GASTROENTEROLOGY | 27 | 5% |
| FERTILITY | 24 | 4% |
| CARDIOLOGY | 11 | 2% |

**Figure 4: Transaction Volume by Specialty for 2022**[5]

While private equity has been driving most of the deal volume in the physician practice sector, health systems are increasingly interested in competing with private equity for certain transactions. For example, health systems have implemented or are considering ownership models of practices at either the controlling or non-controlling level in which physicians maintain ownership interest and retain a higher degree of autonomy and governance. While these models do not include rollover equity like private equity PPM transactions, they may include profit-based compensation plans and typically leverage the system's payor contracts and supplies arrangements. Historically, many large hospitals and health systems have structured physician practice acquisitions based on tangible asset value plus an increase in go-forward compensation for the selling providers (and employed providers). With private equity and other buyers active in the industry, hospitals and health systems have had difficulty competing given the multiples other acquirers are willing to offer. To close transactions, hospitals and health systems are increasingly willing to pay practices for intangible assets that they may not have considered in the past. Attributes that contribute to intangible value at physician practices include but are not limited to the following: having a large number of employed providers, level of difficulty in recreating a practice, ancillary revenue streams, favorable contracts, and other unique situations.

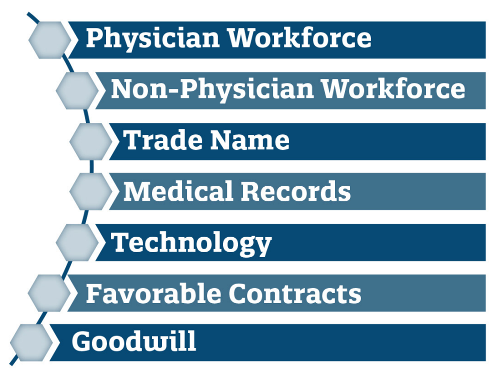


**Figure 5: Intangible Assets Commonly Valued in Health System-led Physician Practice Acquisitions**

### What Will Happen to Valuation Multiples?

While public market valuation multiples declined by approximately 12 percent, the average healthcare transaction multiple declined by approximately 9 percent in 2022.[6] While every transaction is unique, declines in valuation multiples across the industry are largely attributable to higher interest rates, coupled with the fact that many subsectors of the healthcare industry had seen valuation multiples reach elevated levels in recent years.

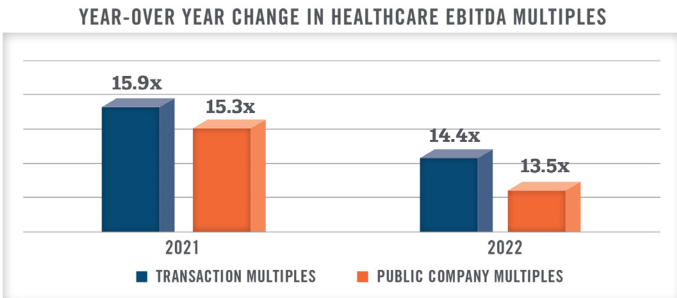


**Figure 6: Year-Over Year Change in Healthcare EBITDA Multiples**

The outlook for interest rates suggests that the cost of capital will continue increasing, with many projections from Wall Street firms and the Federal Reserve's "dot plot" suggesting that short term rates will increase from approximately 4 percent at the end of 2022 to 5 percent in 2023.[7] In addition, the full impact of higher rates has not yet made its way through the economy as many borrowers took advantage of lower interest rates prior to the recent increases. While these factors suggest that valuation multiples will likely be flat or lower in 2023, many buyers continue to be strategic, and the scarcity of certain types of providers in certain markets leads to competition for deals. For example, assets that are unlikely to see lower valuations in 2023 include platform-size physician practices (particularly those in orthopedics, cardiology, and gastroenterology), orthopedic-focused or other highly profitable surgery centers, and women's care/IVF providers. Among newer healthcare companies that are not currently profitable, but which are trying to raise capital in 2023, we believe they will experience down rounds (raising capital at lower valuations than prior capital raises) or be acquired in distressed sales.

### Home Health and Hospice

The M&A landscape in home health and hospice in 2022 was characterized by a decline in overall volume, but two large transactions led to higher overall deal value compared to 2021. The UnitedHealth acquisition of LHC Group and the CVS acquisition of Signify Health represented approximately $14 billion in total transaction value that caused overall deal value to increase more than 70 percent, even though volume fell by more than 25 percent.[8] In 2023, market participants expect a rebound in deal volume given the high level of interest in Medicare certified home health and hospice, as well as private duty nursing and personal care, from private equity and other strategic buyers. The bar graph in Figure 7 presents the share price increase or decrease for each of the publicly traded home health and hospice operators for 2022. We note that CVS announced its intended acquisition of Signify Health in September of 2022.

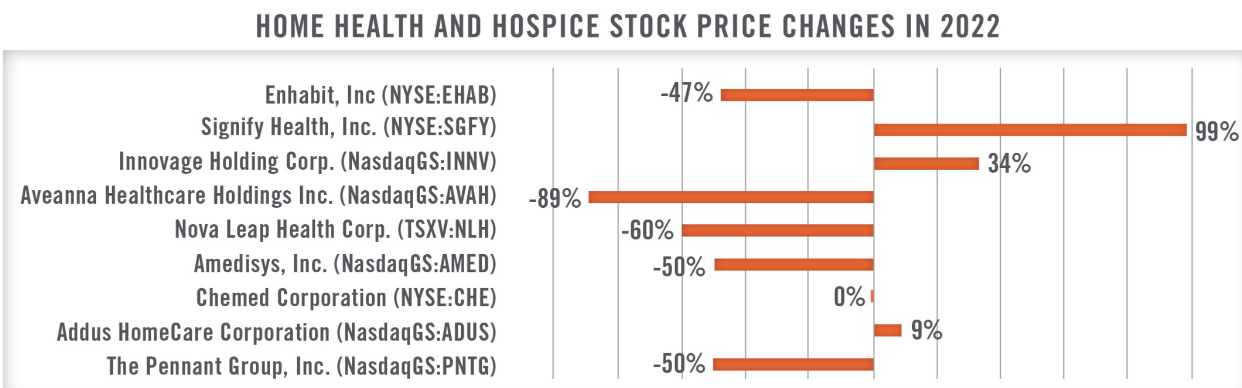


**Figure 7: Home Health and Hospice Stock Price Changes in 2022**

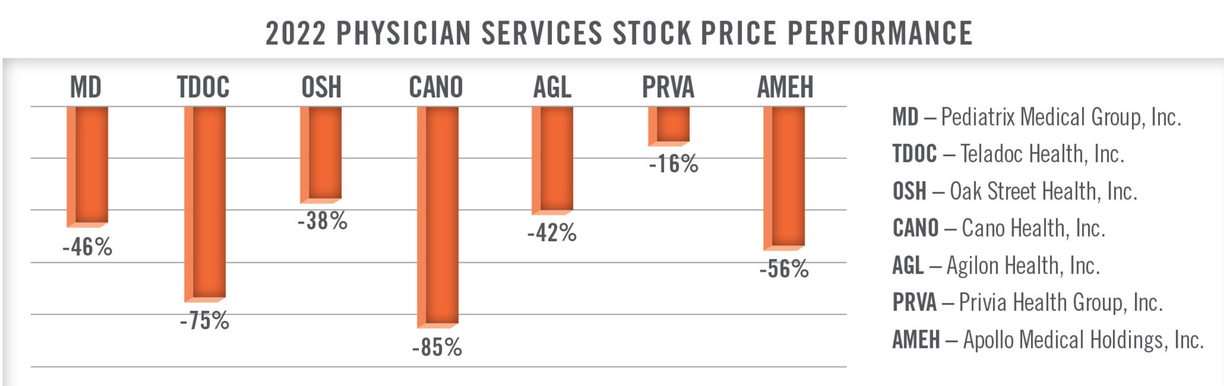


**Figure 8: 2022 Physician Services Stock Price Performance**

### Public Physician Practice Management/Medicare Advantage

2022 was an exciting year for the publicly traded companies focused on value-based care and physician services, and we expect more activity in this sector in 2023. Cano Health (CANO) was in discussions to be acquired by CVS or Humana, although neither company closed a transaction. More recently, CANO's debt was downgraded by Moody's, and it has been rumored to be nearing bankruptcy. Oak Street Health (OSH) is currently in discussions to be acquired by CVS for approximately $10 billion, according to Bloomberg,[9] and Amazon announced plans to acquire One Medical (ONEM) in July of 2022. While not publicly traded, Carbon Health recently raised $100 million from CVS at an undisclosed valuation, although we note the investment came shortly after Carbon Health announced a large layoff. The ability to achieve rapid scale in a sector that is critical in the shift to value-based care is likely to lead to additional interest in the sector from large acquirers in 2023. With the stock prices of many operators down more than 40 percent in 2022, potential acquirers may view these companies as offering an attractive entry point.

### Will Deal Structures Be Impacted by Higher Interest Rates?

As entities enter an environment where raising capital becomes more difficult, we have observed, in recent months, a push by startups and early-stage companies towards acquisitions requiring less upfront cash. For example, alternative deal terms have included stock transactions, long-term promissory notes, and a higher percentage of consideration pushed into an earnout structure. With capital markets tighter than they have been in recent years, early-stage companies will likely continue to focus on conserving cash and look to implement deal structures that help accomplish this goal. We have also observed increased use of right of first refusals (ROFRs) and call options—including long-term call and put options—by prospective buyers. These ROFRs and options enable acquirers to conserve cash and push potential acquisitions to a later date with less risk of losing out on the transaction. More broadly, we have observed more buyer friendly deal structures and transaction processes as acquirers have started facing less competition for targets.

1 *LevinPro HC*, Levin Associates, 2023, February, levinassociates.com.
2 EBITDA stands for Earnings Before Interest, Taxes, Depreciation, and Amortization.
3 S&P Dow Jones Indices, S&P 500 Health Care, https://www.spglobal.com/spdji/en/indices/equity/sp-500-health-care-sector/#overview (last visited Mar. 15, 2023).
4 FRED Econ. Data | St. Louis Fed., *Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis*, Econ. Research Fed. Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/DGS10# (last visited Mar. 13, 2023).
5 *LevinPro HC*, *supra* note 1.
6 pwc, *Health services: US Deals 2023 outlook*, https://www.pwc.com/us/en/industries/health-industries/library/health-services-deals-outlook.html (last visited Mar. 13, 2023).
7 Fed. Open Mkt. Comm., *Summary of Econ. Projections*, Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve (Dec. 14, 2022, 2:00 pm EDT), https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20221214.htm.
8 pwc, *supra* note 6.
9 Michelle F. Davis, et al., *CVS Is Exploring a $10 Billion-Plus Acquisition of Oak Street Health* (Jan. 9, 2023), Bloomberg, https://www.bloomberg.com/news/articles/2023-01-09/cvs-is-said-to-explore-acquisition-of-oak-street-health (last updated Jan. 10, 2023).

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