

# Healthcare: Why Now?

## A Look at Industry Trends and COVID-19 Impact



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Healthcare is a sector that is undergoing rapid change globally. Current market conditions, driven by the COVID-19 pandemic, highlight the need for continued innovation in the sector. Adams Street believes the need for innovation, combined with the global macroeconomic trends underlying growth in the healthcare sector, create an attractive opportunity and that private equity is particularly well-suited to take advantage of the growth and change occurring in the market today.

### Global Trends

The global healthcare industry has been growing rapidly due to macroeconomic tailwinds that we expect to persist into the future. These tailwinds include several strong demographic trends underpinning the growing need for healthcare: the aging baby boomer population, the growth of the middle class, and the increased prevalence of chronic diseases. From 2018-2022, global healthcare spending is expected to increase at a CAGR of 5.4%, compared to 2.1% projected global GDP growth over that same time period.<sup>1</sup> It is also noteworthy that in the last 50 years, global healthcare has never experienced year-over-year declining growth. And yet despite this consistent growth, the industry is coming to terms with the fact that it must continue to evolve in order to decrease costs and improve the quality of care.

### Evolving Healthcare Systems

The US healthcare system is inefficient and ripe for innovation. While the US spends almost double the amount on healthcare per capita compared with all other Organisation for Economic Co-operation and Development (OECD) countries, healthcare outcomes in the US rank in the bottom half of those same countries on a number of metrics including life expectancy at birth, infant mortality, and quality of primary care. Approximately \$750 billion is wasted in the system on unnecessary or inappropriate care, fraud, and



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billing waste, among other factors.<sup>2</sup> The Affordable Care Act (ACA), passed in 2010 with a focus on cost containment and improving quality of outcomes, shifted the landscape in healthcare. In response to this legislation, new business models were implemented. The most pronounced change is the shift to value-based care models. Value-based care shifts the payment model to focus on quality of outcomes (“fee for outcomes”) as opposed to strictly the delivery of service (“fee for service”). This trend has shifted the cost paradigm in healthcare, putting pressure on healthcare providers such as physician practice groups and hospital systems. Healthcare providers are being forced to invent new care delivery models (oftentimes in settings outside of the hospital) with an emphasis on reducing costs and improving patient outcomes. Along with these changes to the delivery of care, technology has been a driving source for the services around these new business models, including innovation in payments, patient care management, and outcome measurement.

To further alleviate cost pressure on the system, consumers are bearing an increased percentage of the cost for the care they receive. This has led to the consumerization of healthcare – consumers are increasingly involved in their own healthcare decisions, demand more transparency throughout the healthcare system, and want a choice in how they access care. New business models enabled by technology are emerging that allow consumers to “shop” for healthcare based on their needs and desires.

While the US healthcare system is undergoing significant changes, there are also changes occurring in the healthcare systems in Asia and Europe. In Asia, the rise of the middle class is causing a rapid increase in the consumption of healthcare services in both urban and rural areas. Strengthening the capacity and quality of primary care is a key tenet to the reform of the healthcare system. In Europe, given the nationalized healthcare system, government spending makes up a substantial majority of total healthcare funding today. However, the healthcare system is evolving as services are increasingly being outsourced to private providers in order to better contain costs.

### Biology & Technology

Recent technological advancements have had a profound impact on biotechnology globally. In 2000, the cost to sequence the human genome was approximately \$300 million. Today, it is just \$1,000.<sup>3</sup> This has led to an explosion in valuable genomic data and has been a driver behind advancements in precision medicine and the ability to tailor therapeutics and care based on a patient's individual genetic makeup. Artificial intelligence and machine learning are able to digest the increasingly large amount of data now available, which allows for early detection of disease with greater precision than ever before. Adams Street believes that the convergence of biology and technology globally will have an immense impact on the system's ability to identify diseases earlier and with more precision, leading to improved outcomes while decreasing costs.

# Summary of Opportunities

The table below illustrates themes affecting the healthcare landscape.

## Developing Global Themes in Healthcare Expected To Persist

	THEMES	OPPORTUNITIES
BUYOUT ORIENTATED	<b>SHIFT TO VALUE</b>	<ul style="list-style-type: none"> <li>▪ Excessive inefficiencies</li> <li>▪ Shift from fee-for-service to fee-for-outcomes</li> <li>▪ Care delivery moving out of hospitals with an emphasis on reducing costs</li> <li>▪ Consolidating incumbents</li> </ul>
	<b>OUTSOURCED PHARMA SERVICES</b>	<ul style="list-style-type: none"> <li>▪ Pharma companies refocusing on core competencies</li> <li>▪ CROs and CMOs execute processes more efficiently</li> <li>▪ Transition from transactional to relationship-based partnerships</li> </ul>
	<b>CONSUMERIZATION OF MEDICINE</b>	<ul style="list-style-type: none"> <li>▪ Connected devices are transforming patients into consumers</li> <li>▪ Higher deductibles make patients more “choosy”</li> <li>▪ Products being delivered and consumed in the home more frequently</li> </ul>
VENTURE ORIENTATED	<b>DIGITIZATION / COMPUTATIONAL MEDICINE</b>	<ul style="list-style-type: none"> <li>▪ Tech and AI transforming healthcare and driving efficiency</li> <li>▪ Intersection of software, biology, and healthcare</li> <li>▪ IT adoption and spending rapidly increasing</li> <li>▪ Tech entrants providing new sources of capital</li> </ul>
	<b>PRECISION MEDICINE</b>	<ul style="list-style-type: none"> <li>▪ Increasingly individualized solutions for patients</li> <li>▪ DNA sequencing is improving target drug discovery and validation</li> </ul>

Adams Street believes the themes listed above will continue to create high-quality opportunities in both the buyout and venture asset classes globally, driven by the evolving healthcare systems as well as technological advancements.

## COVID-19 Impact

While the global trends underlying the healthcare industry are large and growing as described earlier, the current COVID-19 pandemic continues to evolve at a rapid pace which makes its ultimate impact difficult to predict. However, there are pockets within healthcare that have started to see softness, and sub-sectors in which we expect to see softness in the near term, while others are benefitting from current market conditions. Businesses may experience short-term revenue and cash flow declines as a result of decreasing demand, driven primarily by shelter-in-place orders, but overall we believe that the demand impact is temporary and is likely to rebound when the pandemic ceases and markets reopen.

### NEAR-TERM POSITIVE IMPACT:

- **Telehealth / Virtual care** – Companies providing virtual services are becoming the standard of care in this environment as providers are limiting in-person visits to acute, emergent cases.
- **Home health** – Companies providing in-home care have seen volume increases as self-quarantine becomes more pervasive across the country and the globe.
- **Medical device and product manufacturers** – Near-term supply constraints should provide a boon to medical device and product manufacturers, particularly those focused on personal protective equipment and devices related to the COVID-19 pandemic (e.g., gloves, masks, respirators).

### NEAR-TERM NEGATIVE IMPACT:

- **Healthcare providers / services** – Healthcare providers, specifically providers of elective or non-emergent procedures (e.g., dermatology, dental, gastrointestinal) are seeing a dramatic decrease in volume

and therefore revenues. This is most acute in large cities where the shelter-in-place orders have been most prevalent, but we expect this to be a global phenomenon. A large portion of these businesses have been closed for the foreseeable future and we expect meaningful declines as a result.

- **Companies running clinical trials** – Companies running clinical trials are expected to be impacted as access to patients becomes more difficult and hospitals limit outside visitors. Some companies have halted running clinical trials as they are preserving ICU services for those patients most in need.
- **Drug companies reliant on the global supply chain** – Given the global nature of COVID-19, drug companies that rely on a global supply chain are expected to be impacted. Asia is a major provider of inputs to drugs, and countries such as Ireland, Spain, and Italy are major producers of final drug products. As these countries are each individually affected, drug companies are expected to be impacted.

While Adams Street expects short-term volatility in the sector, we believe that the healthcare industry (demand for products and services) will ultimately be a net beneficiary as a result of the COVID-19 pandemic. First, in our view, the underlying demand on the healthcare system will not go away. In this period, volumes will most certainly be deferred as individuals do not receive elective treatment particularly in shelter-in-place geographies. However, after the crisis passes, we would expect individuals to resume these foregone procedures. In addition, the COVID-19 pandemic exposed many issues as it relates to the preparedness of healthcare systems around the world to deal with such an event. We believe that the demand for health-related products and technology will not only resume but increase as providers attempt to better respond to drastic increases in patient volume.

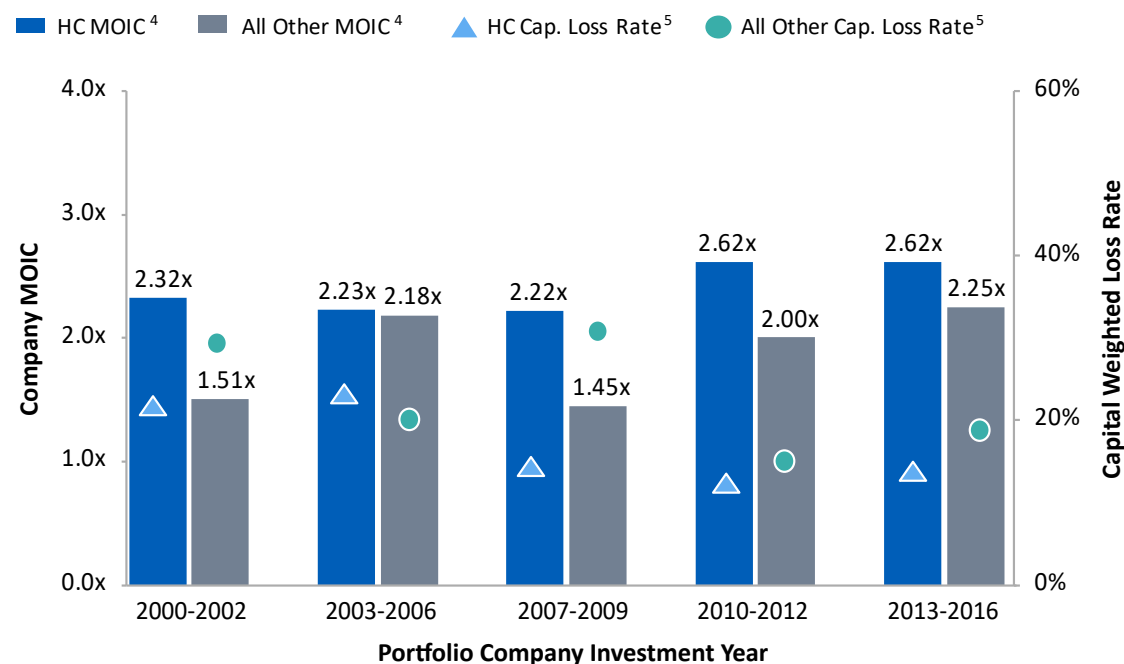


## COVID Impact

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This downturn is unprecedented, and the depth and breadth of the impact remains to be seen. However, healthcare has historically been a sector that has been less susceptible to market downturns as compared to other sectors.

### Private Equity-Backed Healthcare Companies Resilient Across Cycles<sup>4</sup>

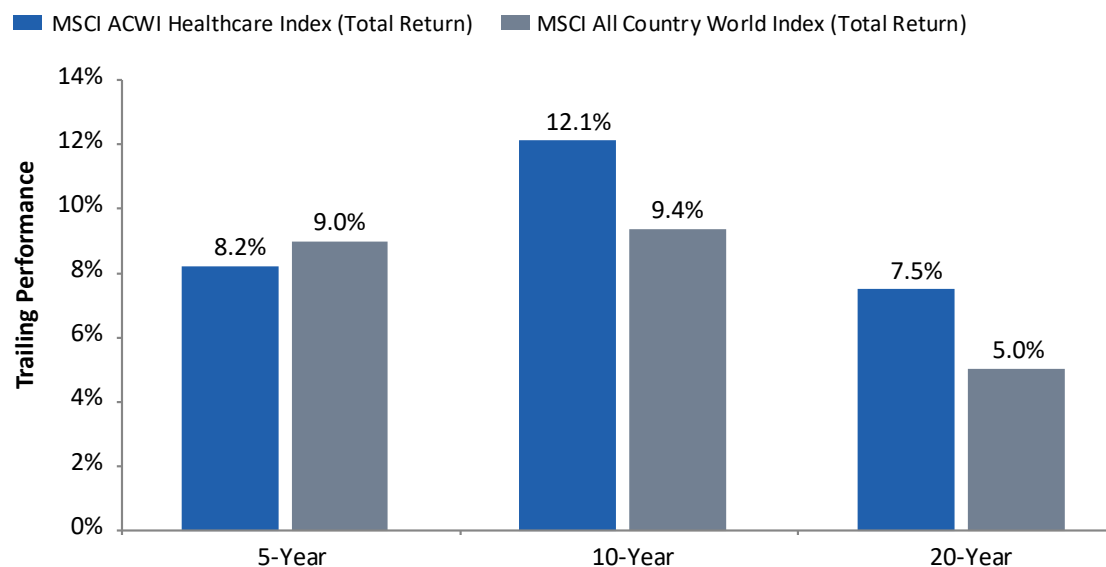


Source: Adams Street as of December 31, 2019.

Note: Sector classification determined by Adams Street. Limited to investments for which at least 50% of the total value has been realized as of December 31, 2019.

Healthcare as a sector has generally outperformed in the public markets over long periods of time. Specifically, over the past 20 years, the MSCI ACWI Healthcare Index has outperformed the MSCI ACWI Index by 250 basis points.

### Long-Term Outperformance of Healthcare in Public Markets



Source: Adams Street as of December 31, 2019.





## In Summary

We expect private equity to continue to play an integral role as a solutions provider to the healthcare industry and believe that the ability for private equity to effect change outside of the public markets (e.g., managing to public earnings) is attractive given the growth and disruption occurring in the industry today. Private equity has been instrumental in funding new and highly innovative business models, making existing infrastructure more efficient, and investing in technology-enabled healthcare solutions to decrease costs and increase efficiency. In periods of market dislocation, particularly one driven by a pandemic, the innovation spurred by private equity is vital to the health of the system. Adams Street continues to focus on investment opportunities that leverage technology and business model improvements to contain costs, enhance the quality of care and outcomes, and improve the consumer experience across the healthcare landscape. We believe that companies solving these problems can dynamically change the current construct of the healthcare industry, creating a system that delivers better quality of care and drives value across the entire supply chain. ■

1. Source: <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Life-Sciences-Health-Care/gx-lshc-hc-outlook-2019.pdf>
2. Source: <https://khn.org/morning-breakout/iom-report/>
3. Source: National Human Genome Research Institute (accessed May 2019)
4. Data set includes 11,614 portfolio companies in which private equity funds invested in the specified years, about which Adams Street has data by virtue of investing in such funds. MOICs and all other information shown are gross of fees, carried interest and expenses charged to the applicable private equity funds. Multiple on Invested Capital (MOIC) reflects the total value (realized value plus net asset value) divided by total invested capital. There can be no guarantee that unrealized investments will ultimately be liquidated at the values reflected in this return data.
5. Capital Loss Rate defined as the total capital loss across company level investments (underlying portfolio companies of primary fund investments) divided by the total capital invested across the company investments (gross of all fees, carried interest and expenses).

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