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INSIGHTS FROM THE BDO CENTER FOR HEALTHCARE EXCELLENCE & INNOVATION

PROJECTING PRIVATE EQUITY'S INTEREST IN HEALTHCARE

Summary

62% of healthcare organizations are planning to **pursue a transaction** in 2022.

Dealmaking is happening more slowly and methodically than in 2021, impacted by more stringent due diligence and a lack of resources.

Private investors have a growing interest in hospital systems, which traditionally have not been primary investment targets. **Hospital systems may be targets for opportunistic deals.**

WHAT TO ANTICIPATE

The healthcare industry saw a whirlwind of deal activity in 2021.

Now, more than halfway through 2022, we are seeing activity slow down — but that does not mean deals are going away. In our **2022 Healthcare CFO Outlook Survey**, 62% of healthcare organizations said they planned to pursue a transaction in 2022.

What's changing isn't investor interest in healthcare opportunities, it's how they look at healthcare opportunities.

In this article, we will discuss three major trends we are seeing in healthcare dealmaking: increased due diligence, reduced resources and opportunistic deals.

DEALS LED BY DILIGENCE

In 2021, buyers were facing steep competition for targets. At the same time, they were pressured to close deals by the end of the year. The due diligence process was in some ways eclipsed by these pressures, resulting in post-close pain points for buyers.

This year, investors are approaching due diligence with a more critical eye. There's less pressure now to finalize deals by a specific date and competition has cooled. As a result, buyers are more likely to renegotiate pricing or alter deal terms based on findings in the due diligence process. For these reasons, we expect buyers to move more slowly and cautiously in the deal process.

REDUCED DEALMAKING RESOURCES

While an increased focus on due diligence threatens to slow down and even halt deals, PE buyers and their targets possess fewer resources to complete transactions.

From the buy-side, there is a professional services labor shortage — including shortages in accountants and legal representatives — that could slow deals. On the sell-side, healthcare providers are facing back-office challenges, limited provider resources, supply chain and inventory constraints, along with lacking the necessary diligence staff, all of which are creating headwinds in the dealmaking process.

OPPORTUNISTIC DEALS IN STRUGGLING HOSPITAL SYSTEMS

Right now, many healthcare organizations are facing increased financial strain. In our **2022 Healthcare CFO Outlook Survey**, 32% of respondents said they planned to pursue a debt restructuring this year, compared to 17% in 2021.

Hospital systems, in particular, are seeing higher operating expenses (OpEx) due to staffing shortages and supply chain snags. In addition, the need to accelerate digital transformation compelled some healthcare systems to reallocate budgets to upgrade antiquated systems in the past several years. While these upgrades have improved patient safety and increased operational efficiencies, they have in some cases continued to impact providers who must learn how to use them during a time when staffing and budgets are already stretched.

For investors, these distressed systems represent potential targets for opportunistic healthcare deals. With the right financial support, these organizations can be turned around, making hospital systems an interesting landing spot for PE investment amid a broader slowdown in healthcare M&A.

CHECKLIST: How can you make sure your due diligence process goes smoothly?

If you're considering selling your healthcare business in the coming months, you're likely to face increased scrutiny from buyers. Here are eight steps you can take to avoid lengthy renegotiations and deal killers:

1. **Benchmark your organization.** Your potential buyer will want to know the strengths and weaknesses of your compliance programs to accurately assess deal risk. To that end, you'll need to benchmark your program against the industry standard and prepare thorough documentation to present your findings.

2. **Prepare a coding review of your claims.** This review determines whether your organization is billing according to coding guidelines published by the Department of Health & Human Services (HHS) and Centers for Medicare & Medicaid Services (CMS). Systemic failure to comply with coding regulations can trigger compliance audits which can result in thousands of dollars in fines and refunds.

3. **Enlist a tax professional.** Work with a tax professional to review the proposed deal structure and identify potential tax inefficiencies to ensure no value is left on the table.

4. **Get an early audit.** Perform your audit early so you can go to market with audited financials, giving buyers greater confidence in the accuracy of your financials.

5. **Dive into your data.** Review your existing data systems to ensure all data is clean, accurate and located in one place. This makes post-deal integration easier for both you and your buyer.

6. **Be transparent on HR.** Prepare thorough documentation on your HR function, including labor costs. Identify whether any departments have significant talent gaps that need to be addressed so your buyer is fully aware of what aspects of the workforce will need additional investment.

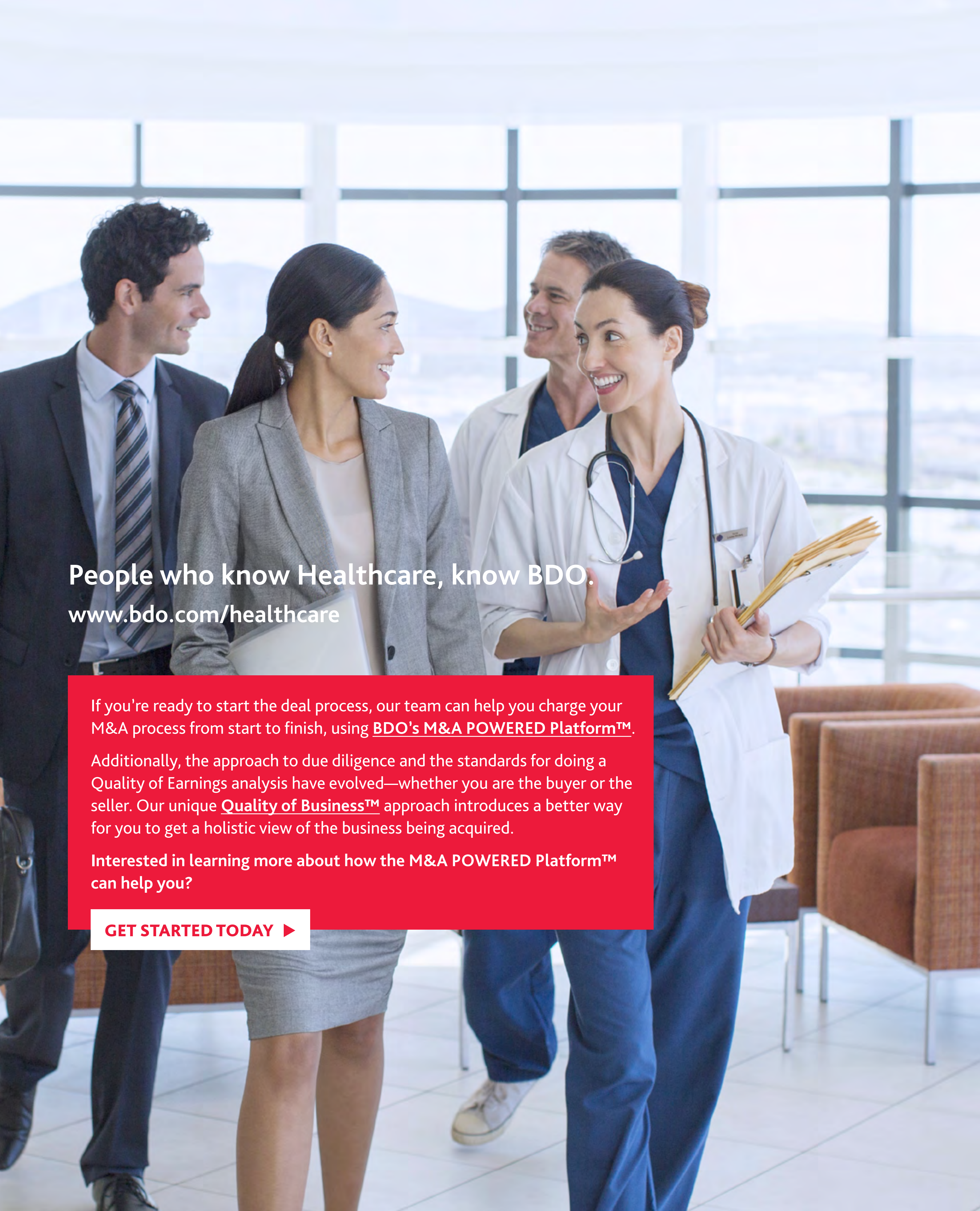
7. **Review your current IT systems.** Make sure your revenue cycle and accounting systems are fully integrated. Consolidate your systems where possible. This makes it easier for the buyer to integrate your IT systems with their systems in a post-deal environment.

8. **Assess operational synergies.** If you know who your buyer(s) could be, evaluate your back office to determine whether there are opportunities for operational synergies. Be prepared to discuss these opportunities in detail to make your offer more enticing to your target buyer.

BDO Insight

As private equity firms look for assets in healthcare, they want to ensure their investment strikes the right balance of risk and reward, that synergies align with the provider organization and that there is an opportunity for growth.

Although the credit markets are tightening, private equity firms still have robust liquidity and are looking to make deals — if the price is right. We expect that upper-middle market deals may take longer to underwrite, as rising inflation goes hand-in-hand with more stringent underwriting standards, while lower-middle market deals may see more flexibility. We also see the potential for greater consolidation of struggling organizations either to be acquired by larger organizations, or through private investors.



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If you're ready to start the deal process, our team can help you charge your M&A process from start to finish, using **BDO's M&A POWERED Platform™**.

Additionally, the approach to due diligence and the standards for doing a Quality of Earnings analysis have evolved—whether you are the buyer or the seller. Our unique **Quality of Business™** approach introduces a better way for you to get a holistic view of the business being acquired.

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