Navigating the Storm: Strategies for Success in Healthcare & Life Sciences Transactions

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1. Introduction

With the pipeline of healthcare and life sciences transactions burdened with higher financing costs, valuation gaps between sellers and buyers, and the impact of geopolitical, economic, and regulatory uncertainty, the sector is turning to fresh value creation models and a deeper focus on thorough deal preparation and due diligence.

Beyond the heyday of cheap debt, competitive auctions, and rising asset prices, investors and acquirers are taking innovative approaches to successful deal execution and focusing on longer-term outcomes. This is requiring additional time, diligent deal preparation, as well as patience to address higher levels of uncertainty and risk.

2. The due diligence imperative

Due diligence has become a higher priority for both sellers and buyers as they seek to smooth the path towards successful deal completion and avoid any unwanted obstacles. This is especially important in a choppy economic, geopolitical, and regulatory environment.

The ever-increasing flood of sector-specific reforms results in a lack of clarity and legal certainty for sellers and buyers. Often, the regulatory and legal framework is somewhat anachronistic, as it does not (or only slowly) reflect the rapid technical and medical progress in some subsectors of the healthcare and life sciences industry. Consequently, innovative business models and products are sometimes not fully aligned with the outdated regulatory requirements. This raises the question for the buyer of whether the regulatory framework simply needs to be interpreted progressively or will be updated – or whether the target's business model is possibly not fully compliant.

Also, transaction structures are often driven by regulatory specifics. By way of example, completing an asset deal may be more complex and time-consuming than a share deal because it typically involves the need for a transfer or re-issuance of regulatory permits or licenses.

Further, foreign investment control by national governments and the EU Foreign Subsidies Regulation have become major hurdles on the way to completing cross-border transactions. As a consequence, elaborate due diligence is more essential than ever to identify potential implications for the deal structure, the purchase agreement, and/or the closing timeline at an early stage of the transaction. This is particularly true for multi-jurisdictional deals because of the many deviating legal standards at national levels. Even in the European Union, a substantial number of sector-specific laws and regulations differ from member state to member state.

Sellers have equally recognized the importance of demonstrating the true appeal of the asset and the route to which a transaction can be executed. Vendor due diligence (VDD) has become critical for injecting greater certainty into deal execution. It is proving essential for clarity, transparency, and the building of trust with the counterparty. VDD can help to prevent deal erosion and any unwelcome surprises further down the track, such as financial adjustments and changes to the purchase price.

VDD can also help to widen the group of bidders. In particular, for investors who are less familiar with the target's subsector or business model, a comprehensive VDD efficiently brings these investors up to speed, while also reducing the buyer's due diligence costs at this early stage.

VDD should always consider the current climate and existing operations, not just the issues that were apparent when the asset was first acquired. Finally, VDD should also dare to take a "look into the crystal ball," i.e., how the regulatory framework will likely change in the coming years, because many investors want to identify future regulatory risks to have more comfort with regard to their own later exit as well.

Purchasers are also seeing the need for more robust due diligence to identify other investment risks and opportunities, make a long-term operational analysis of value creation feasibility, and develop a full understanding of the commercials, including potential returns over the holding period. For private equity investors, it is essential to secure early investment committee approval to cover the cost of extensive due diligence.

3. Value creation and operational efficiency

No longer with the ability to rely on declining interest rates and rising asset prices, purchasers, particularly private equity investors, are facing a much more challenging climate. Higher-for-longer interest rates mean that financial leverage is no longer such an attractive means of increasing returns. As such, private equity buyout multiples have naturally declined.

Purchasers of healthcare and life sciences assets are now having to place a greater emphasis on value creation and operational efficiency strategies to generate returns.

Acquirers and investors are working harder to improve EBITDA margins and growth rates during the holding period. Many are looking to augment operational and organizational structures to enhance EBITDA and improve integration processes.

Strategic and operational due diligence has become increasingly fundamental when acquiring new assets[1]. In particular, with regard to new assets and new business models, purchasers are having to think more carefully about regulatory changes, such as Germany's healthcare reforms, and – as mentioned above – how an asset may be sold in the future. This kind of assessment will typically guide any business integration and restructuring plans.

4. Establishing patience in deal execution

The frantic speed at which deals were concluded in 2021 and 2022 is no longer the rule of the market. On the other hand, patience and meticulousness have become key virtues.

In the current environment, negotiations and deal execution timelines are naturally becoming elongated. Buyers are typically spending more time interrogating the quality of earnings and adjustments while recognizing there will be different value creation propositions, depending on the asset.

In addition, some financial figures are still (positively or negatively) affected by market changes due to the COVID-19 pandemic, making a solid equity bridge and corresponding value analysis even more challenging.

Another obstacle to expeditious transaction execution is the fact that many sellers are still holding out for 2021 valuations when interest rates were at record lows and there was fervent competition for assets. In contrast, buyers are now understandably looking for purchase prices that reflect the current market conditions. Higher interest rates and reduced competition for assets have taken away asset inflationary pressures. This has resulted in a stark valuation gap between the expectations of purchasers and vendors. The situation has been

1 https://www.mckinsey.com/industries/private-capital/our-insights/bridging-private-equitys-value-creation-gap

accentuated by the slowdown in exits and financing rounds, resulting in a lack of benchmarking for asset valuations. Patience has become vital in seeking common ground between buyer and seller.

5. Finding opportunities in the uncertain environment

Although the pipeline of transactions has thinned markedly over the last two years, this period of stasis will likely not continue over the long term. Both sellers and buyers are compelled to strike deals, if only to maintain necessary strategic growth or to meet the obligations of financial sponsors and their investors.

Auctions have become less structured and less competitive, providing more certainty to buyers intent on acquiring assets. Transitioning from a strong „seller's market" (until 2021/2022), the current „buyer's market" offers increasing opportunities for investors to acquire solid HCLS targets (i) at lower valuation levels, (ii) with better conditions on a more favorable contractual basis, and sometimes (iii) in a process that allows the investor to act in an exclusive position. Unsurprisingly, the prospect of obtaining (formal or de facto) exclusivity in deal negotiations has increased substantially.

Many deals failed in 2024 due to two main reasons. First, sellers and their advisers did not diligently prepare the target and transaction. Second, the sell-side marketed the targets too aggressively, i.e., at very high valuation levels. As a result, even after providing more comprehensive information and significantly reducing price expectations, investors nevertheless lost trust and interest and simply exited the process.

There are recent signs that buyer and seller valuation expectations are now converging, and with the growing recognition that the market has experienced a correction, there are increasing opportunities to acquire assets at a discount. With the promise of quick and seamless integration, along with the prospect of a healthy ongoing partnership, buyers are able to emphasize the long-term benefits rather than just the immediate financial rewards.

6. Conclusion and outlook

The obstacles to deals in the healthcare and life sciences sector are beginning to abate. Transactions are not expected to return to the levels seen when interest rates were low and geopolitics and the economy were not undermining market confidence. However, acquirers and investors in healthcare and life sciences assets will not remain on the sidelines for too long. After many exits were postponed, the deal pipeline is now steadily filling up. Buyers and sellers are naturally compelled to seek opportunities to grow and to put money to work. Even if the current environment is not exactly benign, it is slowly but steadily improving. The European Central Bank reduced interest rates this year, with inflation easing across Europe.

Although buy-side investors are still hindered by the recent rise in the cost of debt and the gap between purchaser and seller valuation expectations, there are signs that these factors are becoming less of an impediment.

Both sellers and buyers are recognizing the importance of more extensive due diligence to pave the way for successful deal execution and longer-term value creation. The market now sees value creation and operational efficiencies as the principal factors that will determine whether a transaction is successful. ■

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