Datasite

Where deals are made

The future of due diligence in healthcare M&A

Introduction

The latest prognosis

COVID-19 has thrust the healthcare sector into the spotlight like never before. And for dealmakers, the stakes couldn’t be higher.

R&D breakthroughs, the explosion of the digital health market, and a world pushed to the brink of exhaustion have combined to make the healthcare sector rich with opportunity and risk.

In this 2022 edition of the Future of Due Diligence in Healthcare, we have provided updated mergers and acquisitions (M&A) due diligence benchmarks based on our database of 1,500+ healthcare M&A deals. For this section, we excluded non-M&A transactions, including IPOs, licensing, and fundraising.

We also updated our future healthcare due diligence trends section, drawing from recent large-scale Datasite surveys and in-depth interviews. Our biggest addition: conducting due diligence in an online-first environment.

> **COVID-19 has increased the need for managing transactions online.**

Chapter 1

Today’s benchmarks

A global pandemic. An M&A frenzy. And, it turns out, steeper deal execution challenges across the board.

If you felt like your work was getting harder, you were right. In this chapter, we compare YoY M&A data from 600+ M&A healthcare transactions hosted on Datasite annually to provide the latest benchmarks on due diligence.

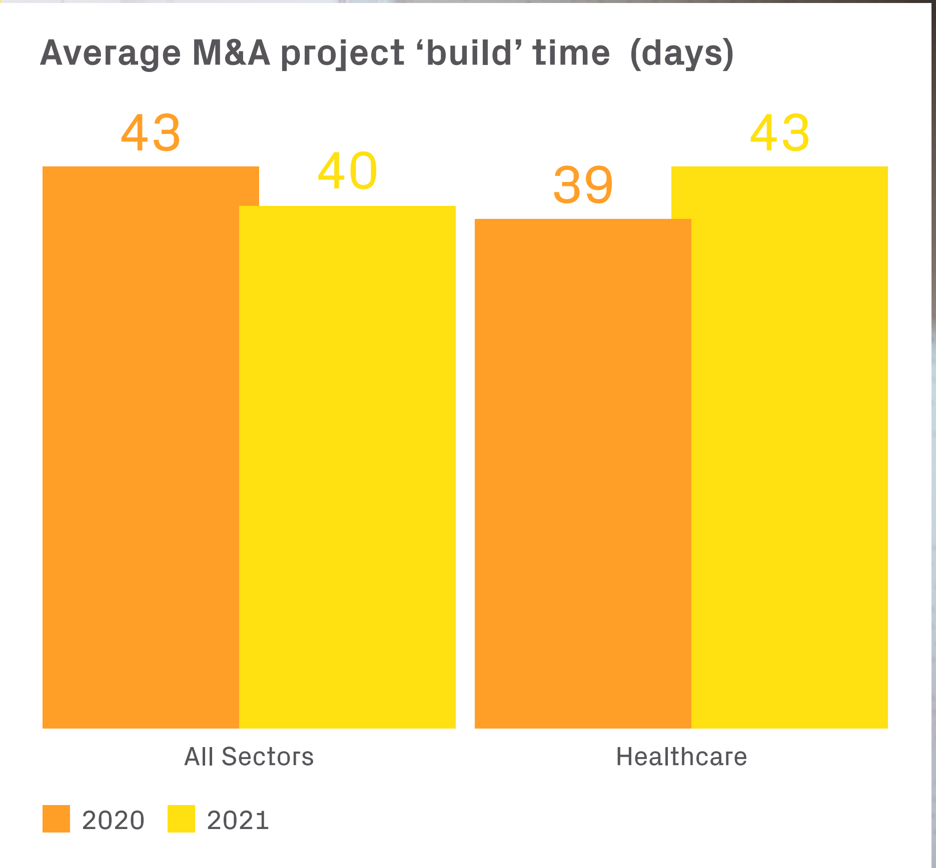
Today’s benchmarks

Prep takes longer

Gathering and organizing documents in the data room (‘build time’) in preparation for launching a healthcare M&A process took an average of 43 days in 2021. Year on year, this represents a four day or 10% uptick in build times from last year.

Interestingly, while healthcare prep took longer, in other sectors it sped up. Build times across all sectors dropped to 40 days in 2021 from 43 the year before for a 7% decrease overall.

Two factors may be slowing down healthcare M&A prep. First, the sheer volume of information needing to be organized shot up 19% vs. 16% YoY in other sectors. Second, healthcare executives may simply be too stretched from handling the brunt of the pandemic to prioritize paperwork.



Today’s benchmarks

Diligence speeds up

Historically, regulation-laden healthcare and life sciences due diligence processes have taken almost three weeks longer to complete than deals in other sectors. But all that changed last year.

Healthcare M&A deals may be slower to launch but they made up for the lag with faster due diligence times. Deals took an average of 262 days to complete – a 40 day drop from the year before and four days faster than the all-sector M&A average of 266 days.

Time-saving technologies are accelerating diligence across all industries. Healthcare, more than other sectors, appears to have embraced the change.

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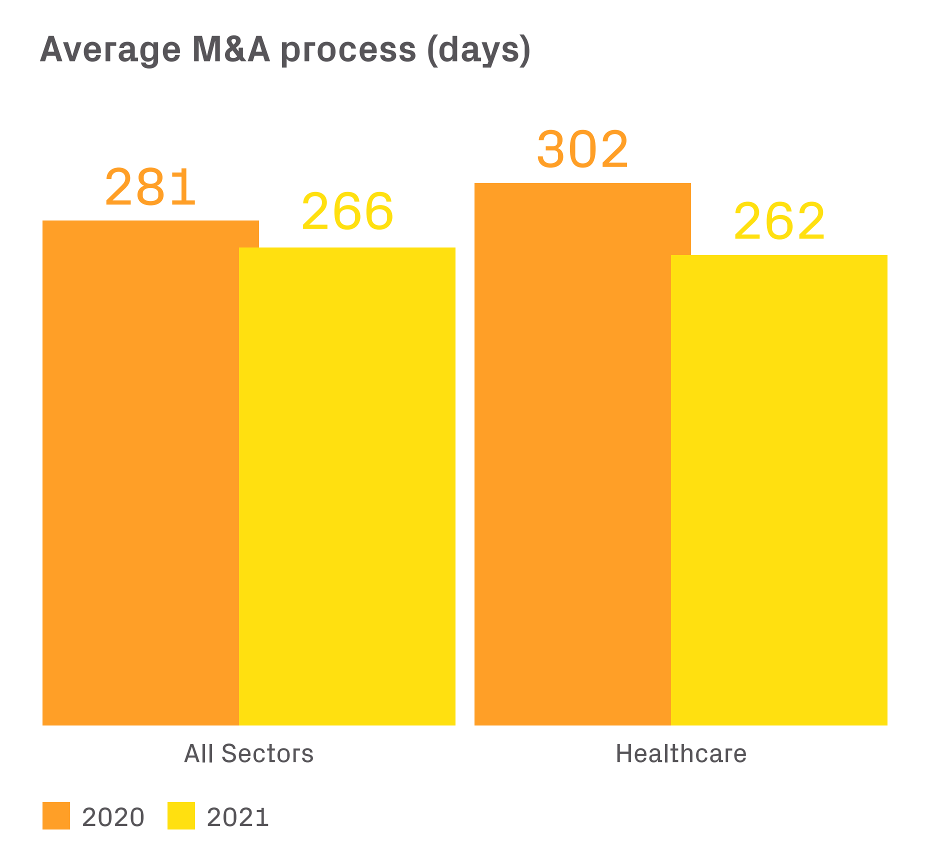
> **COVID-19 has made us more flexible, faster and more agile.**



Chapter 2

Tomorrow’s trends

Even before COVID-19, the dramatic rise of private equity, new technological advances and the increasing professionalization of the M&A industry was pushing old due diligence boxes into new shapes. Healthcare, in particular, has its own distinct challenges, from changing compliance and privacy concerns to antitrust issues. Today, the very concept of due diligence is being tested and redefined.

What are the key factors behind this change? These four trends are reshaping the face of due diligence, according to extensive Datasite polling.

1. Technology first

No one could have imagined the abrupt transformation dealmakers would have to make from a world defined by face-to-face meetings to an online-only environment. Healthcare professionals have embraced online-first as a way of working more than most. For instance, 64% reported continuous data room use, up 33% from the prior year. By contrast, their peers from other sectors reported a mere 48% in continuous use.

Although in-person meetings are no longer taboo, an online-first approach to M&A is here to stay. Advantages include abbreviated management meetings and business travel, productivity boosting tools like AI-enabled auto-categorization and redaction, and, finally, the ability to spend more time with family and friends.

40%

Of healthcare dealmakers are relying more heavily on technology to help with bandwidth constraints, according to one Datasite survey.

33%

Plan to prioritize family time in 2022, according to the same survey, putting time-saving tools at a premium.

Tomorrow’s trends

2. Specialization and communication wins

Globally, 36% of dealmakers pre-pandemic believed private equity’s focus on speed and efficiency is driving the most change in due diligence. And no matter where you sit in the deal ecosystem, the way to achieve efficiency gains and secure ROI is through in-depth industry expertise.

Private equity firms increasingly leverage third-party expert networks and their own subject matter expertise (SME) to win over LPs – and sellers – in a crowded marketplace. M&A associates are encouraged to choose a sector focus much earlier in their careers. Finally, 73% of M&A professionals cite sector expertise as the most important factor in choosing an advisor.

Understanding the industry is especially important in healthcare and life sciences, where valuation is often based on speculative R&D or complex financial ecosystems. Payment models, care delivery, and science are constantly changing. Development times for drugs and other therapies are slow, and even promising therapies may take years to be approved for use.

The ability to communicate the science to investors is particularly important, however, in the COVID-19 era, where meetings tend to be targeted, brief, and virtual. Have a cross-section of people pressure test your messaging, says Jennifer S. Buell, President and CEO, MiNK Therapeutics, in a prior interview with Datasite. ‘An advisor may say, “So what?”’

Excellent science goes underutilized simply because you’re not able to convey the value of that particular asset or tool.

Jennifer S. Buell
President and CEO, MiNK Therapeutics

Tomorrow’s trends

3. Move to continued preparedness

Both buy- and sell-side are shifting from seeing due diligence as a short term, transaction-based process to viewing it as an embedded part of the entire M&A lifecycle. That’s why 23% of global deal professionals, including 25% from North America, cite the shift to continued preparedness as a critical driver behind due diligence change.

Like chess masters, the best buyers think many steps ahead. In the healthcare arena, where products in the pipeline may take years to develop, continued preparedness and forward planning are even more essential. Buyers must take a sustained, strategic approach to build their deal pipeline. This means more time proactively identifying, vetting and developing relationships with potential acquisitions; in many cases, years in advance. The sale itself is merely prelude to a larger endgame, with integration and add-on purchases carefully mapped, long before exclusivity agreements are signed.

“Runway is critical. You don’t want to raise money when you need it.”
Itamar Kandel, CEO of HeartVista

On the flip side, sellers have moved away from the concept of a sale process as a one-and-done short-term endgame. For many, a sale process is merely a stepping stone on a path that involves multiple buyers and long-term strategic growth. As a result, constant asset readiness is critical to taking advantage of fast-moving market cycles, avoiding costly paperwork pitfalls and smoothing the way for future M&A lifecycles.

This is particularly true in life sciences, where the drug development process requires a many-years-long parallel financing track.

Tracks	Pre-clinical			Clinical trials			Post approval
R&D	Basic research	Drug discovery	Pre-clinical	Phase 1	Phase 2	Phase 3	Phase 4
Financial Sample - mixed tactics	Angel investment	Series A listing	Series B listing	Series C listing	Licensing sale partnerships		

Tomorrow's trends

4. Form over function

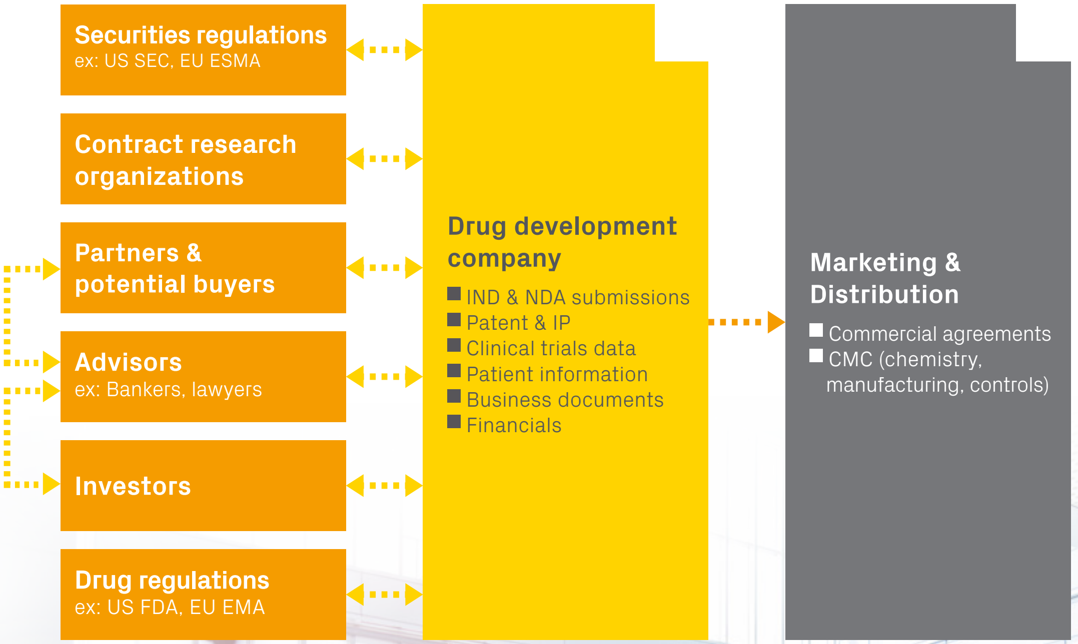
With deal teams often stretching into the hundreds and spurred by the move to a state of continued preparedness and overall industry maturation, dealmakers are adopting a more programmatic approach to the entire M&A lifecycle, including due diligence.

For an industry like healthcare inhabited by the scientifically-minded, this move to assembly line, process-oriented thinking makes inherent sense. However, on the financial services side of the equation, systemic issues, such as lack of project management training and focus at elite business and law schools, high turnover rates for junior banking and legal associates, and widespread nonadherence to centralized, secure document sharing policies, pose ongoing challenges.

Nevertheless, program management best practices are starting to wend their way into M&A. Law firms have begun to take an assembly line approach to contract reviews, either out or insourcing to dedicated specialist groups. Consultants work closely with internal corporate groups to improve processes. Integration PMOs are becoming more standard.

Nowhere is this approach more important than in healthcare and life sciences, where due diligence processes involve more complex analysis – with more external parties - than any other industry. As a result of this complexity, an astonishing 57.8% of dealmakers believe finding all the red flags is the hardest thing to get right in healthcare due diligence, according to Datasite polling.

The R&D document-sharing ecosystem



Tomorrow's trends

Future proof your to-dos

Datasite has distilled insights from top healthcare finance professionals, proprietary due diligence research, and the Datasite project management team to develop a high-level checklist specific to today's market conditions and the healthcare and life sciences sector. Here are some highlights from the checklist.

What is the strategy to address common technology challenges in the healthcare field?

- How do you plan to identify, attract and retain key technology talent?
- How will you ensure effective collaboration between healthcare and technology professionals?
- How will you address data connectivity challenges?

What is the plan to protect sensitive IP, employee and patient records?

- Are you compliant with data privacy regulations in all applicable jurisdictions?
- Is your IP fully protected?
- Are all third parties in the due diligence process using secure transmittal practices and compliant with data privacy regulations themselves?

Have you modeled for geopolitical issues, such as changes in healthcare policy, National Security regulations, trade tensions, and COVID restrictions?

Have you assessed the impact of a potential economic downturn on the asset's business model?

- If a drug, what is the time horizon and how do your financing needs map?
- Is there reoccurring revenue?
- Have you proactively modeled a recession case?

Have you received a third-party due diligence report to ensure financials are accurate and not overly ambitious?

Have you evaluated the target's ESG risk and taken appropriate measures?

- Have you reviewed all the company's internal guidelines, surveys and policies?
- Have you searched court dockets for employment claims?

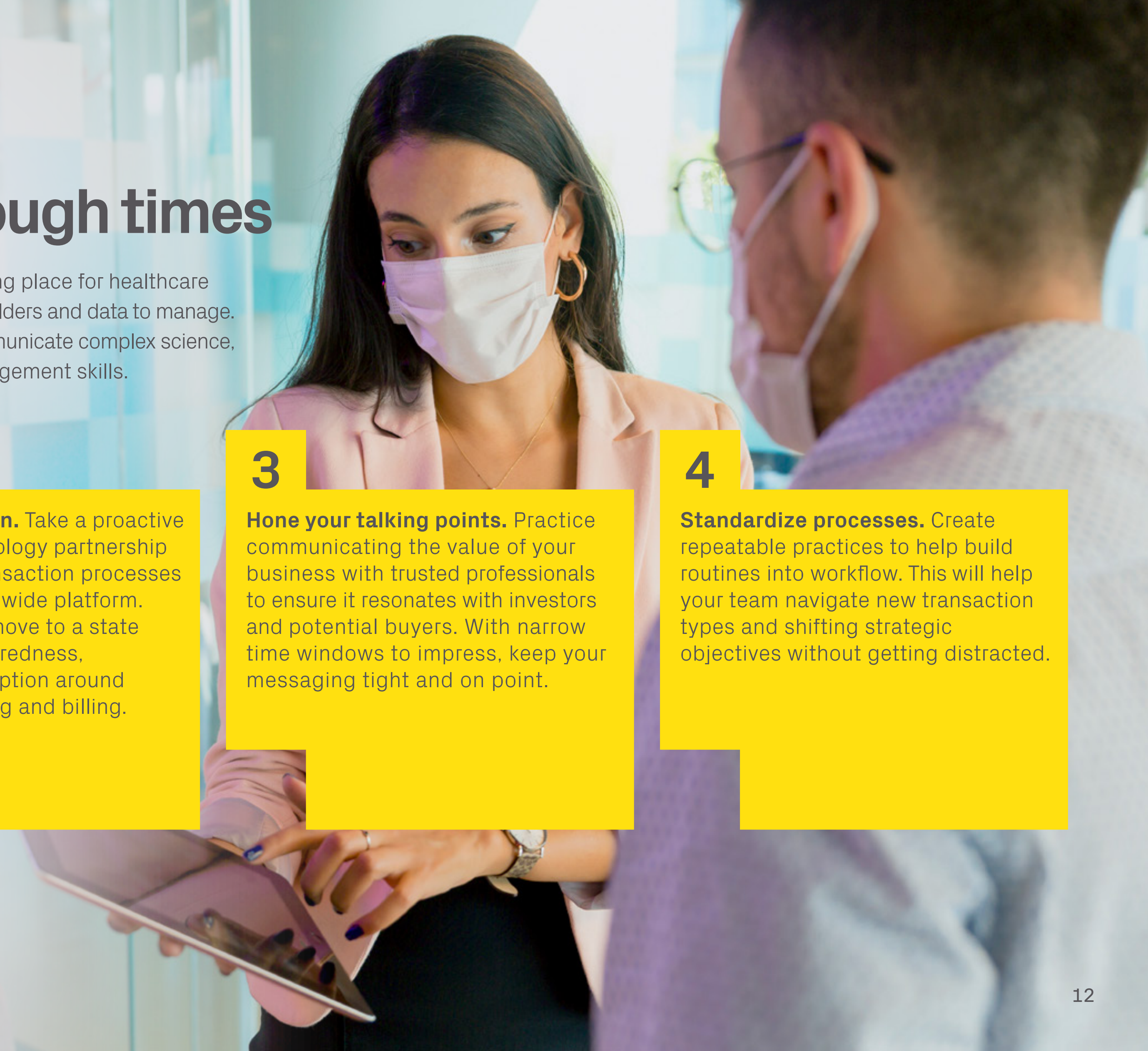
If it's a drug development company:

- Are you clear about how you want the business to mature and where to focus?
- Have you mapped R&D time frames to financing and potential financing tactics?
- What are your relationships with VCs, PE and potential partners - are you clear about the value-add you need in addition to financing?

Conclusion

Four takeaways from tough times

COVID-19 has accelerated the digital transformation already taking place for healthcare professionals running processes with increasing amounts of stakeholders and data to manage. To succeed, healthcare dealmakers must embrace technology, communicate complex science, move to continued preparedness, and sharpen their project management skills.



1

Assess your organization. To make the most of the enforced move online, evaluate with your team what succeeded and what did not from the year before. What aspects of your work should stay virtual and which ones should revert to in-person?

2

Embrace always on. Take a proactive approach to technology partnership by centralizing transaction processes on one, enterprise-wide platform. This will help you move to a state of continued preparedness, and minimize disruption around onboarding, training and billing.

3

Hone your talking points. Practice communicating the value of your business with trusted professionals to ensure it resonates with investors and potential buyers. With narrow time windows to impress, keep your messaging tight and on point.

4

Standardize processes. Create repeatable practices to help build routines into workflow. This will help your team navigate new transaction types and shifting strategic objectives without getting distracted.

Your home for healthcare today, so you're ready for tomorrow

Life-saving work. Fraught R&D and pharma due diligence time frames. HIPAA and GDPR compliance. Managing financial transactions in the healthcare and life sciences industry has never been harder - or more important. Whatever your deal stage or type, Datasite has you covered.

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