February 2023

Lazard Healthcare Services Leaders Study 2023

Executive Summary

LAZARD

Lazard Healthcare Services Leaders Study 2023

The U.S. healthcare services industry in 2022 faced challenging operating conditions and market volatility, driven by macroeconomic uncertainty, a tight labor market, supply chain disruptions, and other factors. These factors created a gap between buyer and seller views of value and price, which diminished M&A and financing activity. Meanwhile, industry participants have become significantly more discerning about the sustainability of revenue growth, level of and timeline to profitability, ability to drive clinical and financial outcomes, and competitive differentiation, among other considerations.

Against this backdrop, in November and December 2022 we fielded responses to inform Lazard's Healthcare Services Leaders Study 2023. We received input from 150 leaders[1] across many of the largest healthcare services companies, as well as smaller public and private companies and prominent investment firms.

The respondents comprise 99 top C-level healthcare services executives and 51 leading healthcare services investors. Among the C-level executives, 12 are from large-cap public companies and 20 are from SMID-caps, while 67 are from private companies.

Our Central Findings

1. Healthcare services equity market conditions are unlikely to recover to normalized, sustainable levels before the second half of 2023. A market recovery will be catalyzed by an improved macroeconomic outlook, greater access to capital, and improved investor sentiment toward sector profitability.
2. While large-cap consolidation is expected to remain at the same relatively low level, bolt-on acquisitions, together with partnerships/collaborations and corporate carve-outs, are expected to increase. Improvements in seller price expectations, the availability of capital, and buyer perceptions of lower risk in achieving forecasts will be important catalysts of rising strategic activity.
3. Mental/behavioral health, software, and primary care are expected to receive greater investment in 2023 than in 2022, followed by home health and outsourced pharma services. Least likely to receive greater investment in 2023 are facility-based acute and post-acute care and managed care insurance.
4. The ongoing shift of care volume to alternative sites and the transition to value-based care are the forces expected to most transform healthcare services over the coming decade, followed by a rise in consumerization of healthcare, vertical integration of healthcare groups, and widespread utilization of virtual healthcare.
5. Most healthcare services leaders believe that a majority of healthcare payments will be governed by alternative payment models (i.e., value-based care) within the next five years. The transition to value-based care has been most limited by provider preference for fee-for-service reimbursement, suboptimal design of value-based programs, and insufficient data analytics capabilities.

SURVEY RESPONDENTS

150
Healthcare Services Industry Leader Responses

99
C-Level Executives

51
Investors

C-SUITE BREAKDOWN

12
Large-Cap Public Company Participants

20
SMID-Cap Public Company Participants

67
Private Company Participants

1 C-level executives including CEOs, CFOs, and senior executives involved in strategic decision-making. Large-cap healthcare services companies were defined as those with enterprise values (equity value + debt) of greater than $15 billion. Small and mid-cap ("SMID-cap") companies were defined as those with enterprise values of less than $15 billion.

1 Healthcare services equity market conditions are unlikely to recover to normalized, sustainable levels before the second half of 2023. A market recovery will be catalyzed by an improved macroeconomic outlook, greater access to capital, and improved investor sentiment toward sector profitability.

Expectations for Timing of Healthcare Services Market Recovery

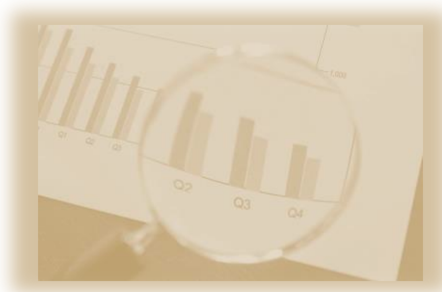
Almost no respondents—just 3%—believe that there will be a healthcare services market recovery during the first half of 2023. Respondents are divided on whether a recovery is more likely in the second half of 2023 or 2024. Notably, a plurality of respondents believe that public markets will recover in the second half of 2023, while private markets will not recover until 2024.

Investors are somewhat more bullish than are corporate executives about the timeline for recovery, with more than half of investors believing both public and private market recoveries will occur by the second half of 2023, as compared to 45% and 38% of total respondents believing so for public and private markets, respectively.

Provider services leaders are the most bullish on the timeline for recovery, with 82% and 64% predicting that that equity market conditions will recover in the second half of 2023 for public and private companies, respectively.

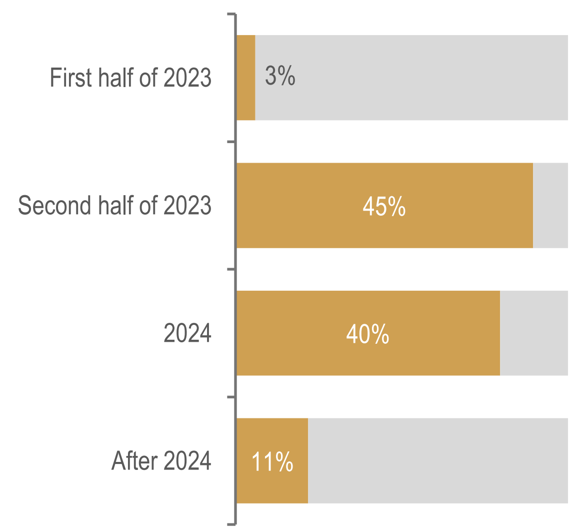
Only 3%

of healthcare services leaders believe there will be a healthcare services market recovery in the first half of 2023

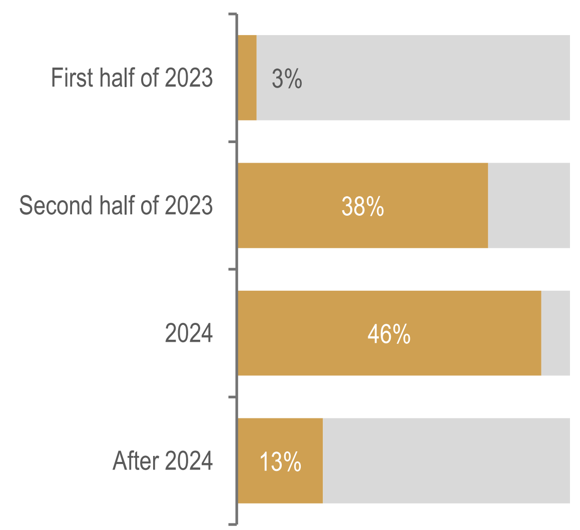


Q: ***When do you expect U.S. HC Services equity market conditions to recover to a normalized, sustainable level?***

For Publicly Traded Companies

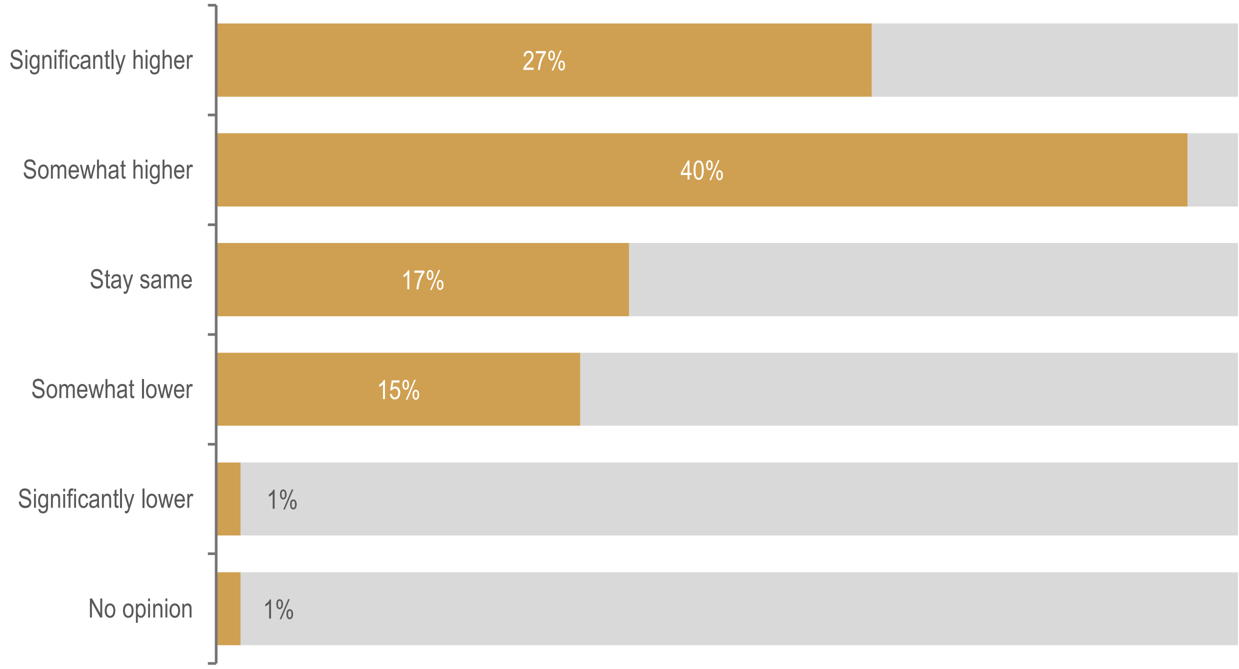


For Privately Held Companies



When asked specifically about expectations for hospitals, 67% of healthcare services leaders expect hospitals to be under greater operational and financial strain in 2023—underscoring the extent of the near-term challenges facing hospitals. However, only half of provider leaders expected the same.

Q: ***How great will the operational and financial strain on hospitals be in 2023, relative to 2022 (e.g., with respect to staffing/labor costs) (select one)?***



Catalysts of a Healthcare Services Market Recovery

Over 90% of healthcare services leaders believe that an improved macroeconomic outlook—including tempered inflation, consensus on monetary policy, and a better global growth outlook—will be the most important catalyst of a sustained recovery of the U.S. healthcare services equity market. This key driver is followed by greater access to debt and equity capital (52%) and improved investor sentiment toward sector profitability and cash flow outlook (45%).

Managed care organization ("MCO") executives are particularly focused on higher levels of M&A and business development activity as drivers of a sustained recovery in the U.S. healthcare services equity market (60% of MCO executives have this view, compared to 28% of respondents overall). On the other hand, no MCO executives cite greater access to debt or equity capital as a top factor expected to drive U.S. healthcare services equity market performance.

Over 90%

of healthcare services leaders believe that an improved macroeconomic outlook will be the primary catalyst of a sustained recovery of the U.S. healthcare services equity market

Only 21% of supply chain/pharma services executives view improved investor sentiment toward sector profitability and cash flow outlook as a key contributor to market recovery. However, 37% of supply chain/pharma services executives expect an improved geopolitical situation to drive sustainable market recovery, compared to just 23% of total respondents.

Almost 70% of investors believe that greater access to debt and equity capital will be a key driver of market recovery, compared to 52% of all respondents—highlighting their reliance on the capital markets to finance their investments.

Notably, fewer than 5% of healthcare services leaders believe an improved antitrust outlook to be an important driver of a sustained recovery in the U.S. healthcare services equity market.

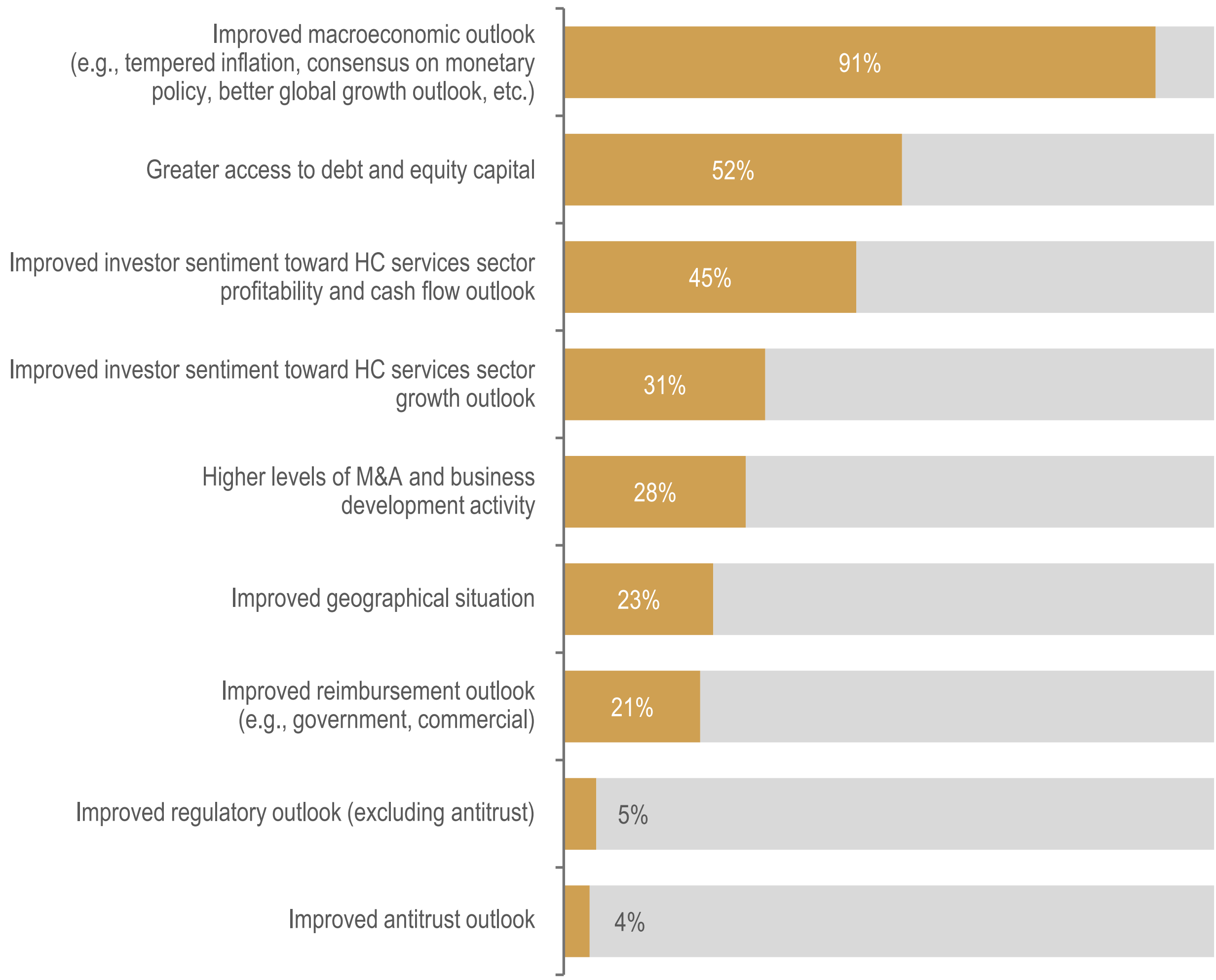
Almost 70%

of investors believe that greater access to debt and equity capital will be a key driver of market recovery, compared to

just 52%

of respondents overall

Q: ***What are the top 3 factors that you expect to drive a sustained recovery of the U.S. HC services equity markets?***



Availability of Capital

There is significant pessimism and uncertainty about the availability of capital for companies in the first half of 2023[1], with a substantial majority of respondents believing that equity and debt capital will be difficult to obtain and only available at most at the same low levels as in the past six months.

Healthcare services leaders are particularly pessimistic about the availability of capital from venture capital and for IPOs, with only 16% and 12% of respondents, respectively, expecting greater availability in the first half of 2023. That said, investors are somewhat more positive, with 22% and 24% expecting greater availability of capital from venture capital and for IPOs, respectively. Notably, only 4% of private company leaders expect greater availability of capital for IPOs, and no large-cap public company leaders expect greater availability of venture capital.

Healthcare services leaders are somewhat less pessimistic about the availability of capital from private equity, growth equity, and follow-on public financings, with 26% expecting that these sources of capital will be more available. Large-cap public company leaders are more pessimistic than respondents overall about the availability of private and growth equity, with only 8% expecting greater availability in the first half of 2023.

Respondents are also somewhat less pessimistic about the availability of debt, with 29% expecting that debt financings will be more available in the first half of 2023, relative to the preceding six months. Investors are more optimistic, with 41% expecting greater availability of debt.

Only 29%

of healthcare services leaders expect debt financing to be more available in the first half of 2023; they are even more pessimistic about the availability of all forms of equity capital

Q: ***How available do you expect capital to be for companies in first half of 2023, relative to the past six months (select one for each type of capital/financing)?***

	Private Equity & Growth Equity	Venture Capital	IPOs	Follow-on Equity	Debt Financings
Significantly Higher	0%	2%	1%	1%	1%
Somewhat Higher	26%	14%	11%	25%	28%
Stay Same	33%	33%	32%	31%	23%
Somewhat Lower	35%	34%	23%	37%	33%
Significantly Lower	6%	17%	32%	5%	14%

0% 50% 100%

1 Relative to the past six months

2 While large-cap consolidation is expected to remain at the same relatively low level, bolt-on acquisitions, together with partnerships/ collaborations and corporate carve-outs, are expected to increase. Improvements in seller price expectations, the availability of capital, and buyer perceptions of lower risk in achieving forecasts will be important catalysts of rising strategic activity.

Expectations for M&A and Partnership Activity

While only 21% of respondents believe that large-cap consolidation will increase in the first half of 2023[1], more than half of respondents expect bolt-on acquisitions to increase.

In addition, 48% and 41% of respondents expect partnership/ collaboration and corporate carve-out activity, respectively, to increase.

Notably, 50% or more of public company executives (both large- and SMID-cap) and investors, versus 41% of all respondents, expect corporate carve-out activity to increase in the first half of 2023.

While 75% of large-cap public company leaders expect partnership/ collaboration activity to increase in the first half of 2023, only 25% of SMID-cap public company leaders agree.

52%

of respondents expect bolt-on acquisition activity to increase in the first half of 2023;

75%

of large-cap public company leaders expect partnership/collaboration activity to increase

Q: ***How much corporate development activity do you expect there to be in first half of 2023, relative to the past six months (select one for each type of corporate development activity)?***

	Large-Cap Consolidation	Bolt-on Acquisitions	Corporate Carve-outs/ Business Separation	Partnerships/ Collaborations
Significantly Higher	0%	7%	4%	11%
Somewhat Higher	21%	45%	37%	37%
Stay Same	35%	23%	33%	39%
Somewhat Lower	35%	19%	22%	11%
Significantly Lower	9%	5%	4%	2%

0% 50% 100%

1 Relative to the past six months

Challenges to Executing Deals in the Current Environment

82% of respondents regard seller price expectations as a key barrier to M&A in the current environment.

Notably, 94% of investors and 92% of large-cap public company executives view seller price expectations as a key barrier to M&A, versus 70% of SMID-cap public company executives and 75% of private company executives. This divergence is unsurprising, given differing perceptions between buyers and sellers of intrinsic value and pricing.

68% of respondents view limited availability and/or high cost of debt financing as a key barrier to M&A in the current environment.

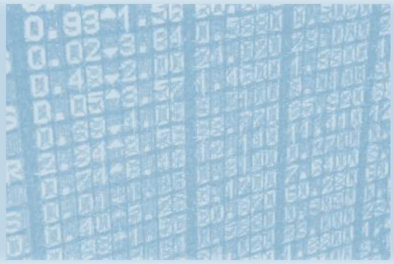
While 78% of investors have this view, only 58% of large-cap company leaders agree—reflecting large-cap companies' stronger access to balance sheet and other sources of capital.

Almost 45% of healthcare leaders view buyers' perceived risk of achieving combined company forecasts as a key challenge to M&A in this environment.

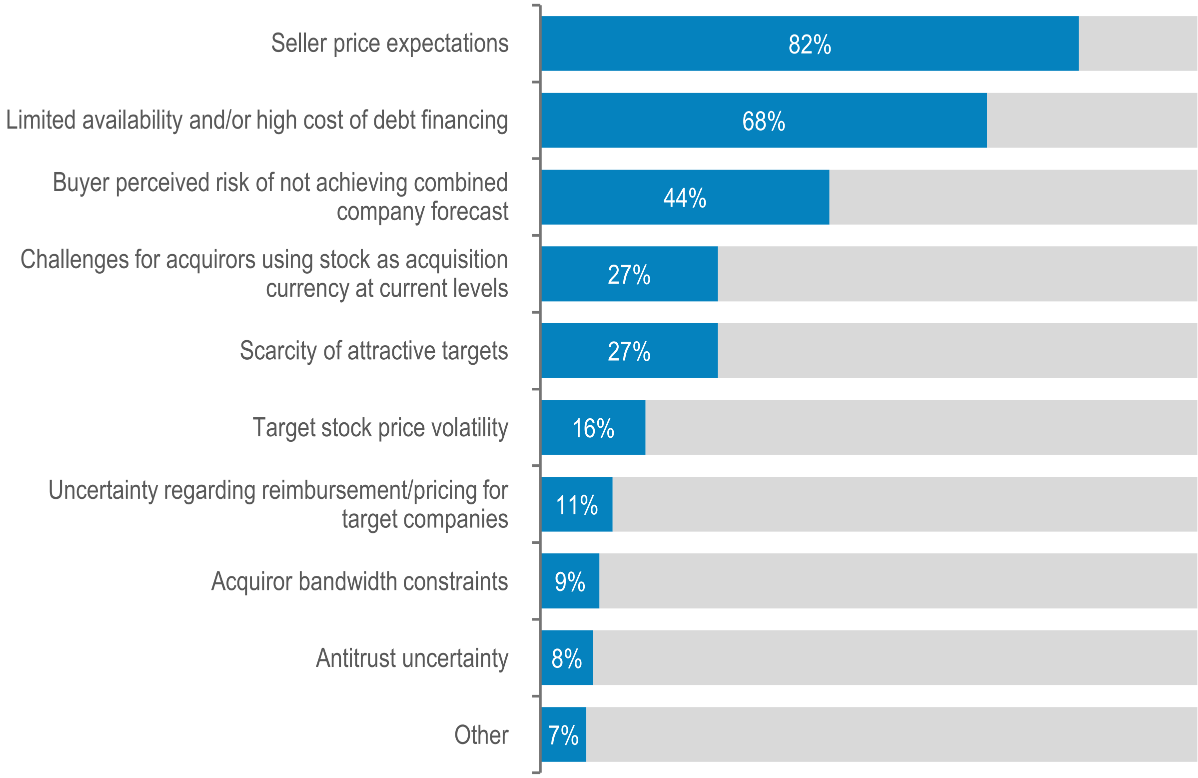
Notably, despite the muscular antitrust posture of the Department of Justice and Federal Trade Commission, only 8% of respondents regard antitrust uncertainty as a key barrier to M&A.

82%

of respondents regard seller price expectations as a key barrier to M&A in the current environment



Q: ***What are the top 3 challenges to executing HC services M&A in the current environment?***



Catalysts of Greater Deal Activity

Given that seller price expectations and challenging deal financing markets are regarded as the top barriers to M&A currently, it is unsurprising that respondents view improvement on these fronts as the most important catalysts of greater M&A activity in the first half of 2023.

Over 70% of healthcare leaders regard more reasonable seller price expectations as a key driver of greater M&A activity.

Greater access to/lower cost of debt financing (52%) and improved macroeconomic environment (42%) are also viewed as key drivers of increased deal activity.

Investor and large-cap executive opinions diverge meaningfully, with 71% of investors pointing to improved debt financing markets as a key deal catalyst, versus only 33% of large-cap public company leaders.

Notably, 58% of large-cap healthcare services executives and 45% of SMID-cap healthcare leaders (versus only 32% of total respondents) view the need to add strategic capabilities as a key catalyst of greater M&A activity.

30% of SMID-cap leaders point to the need to increase profit margins and/or cash flow as a key catalyst of increased M&A activity in the first six months of 2023, versus just 18% of overall respondents.

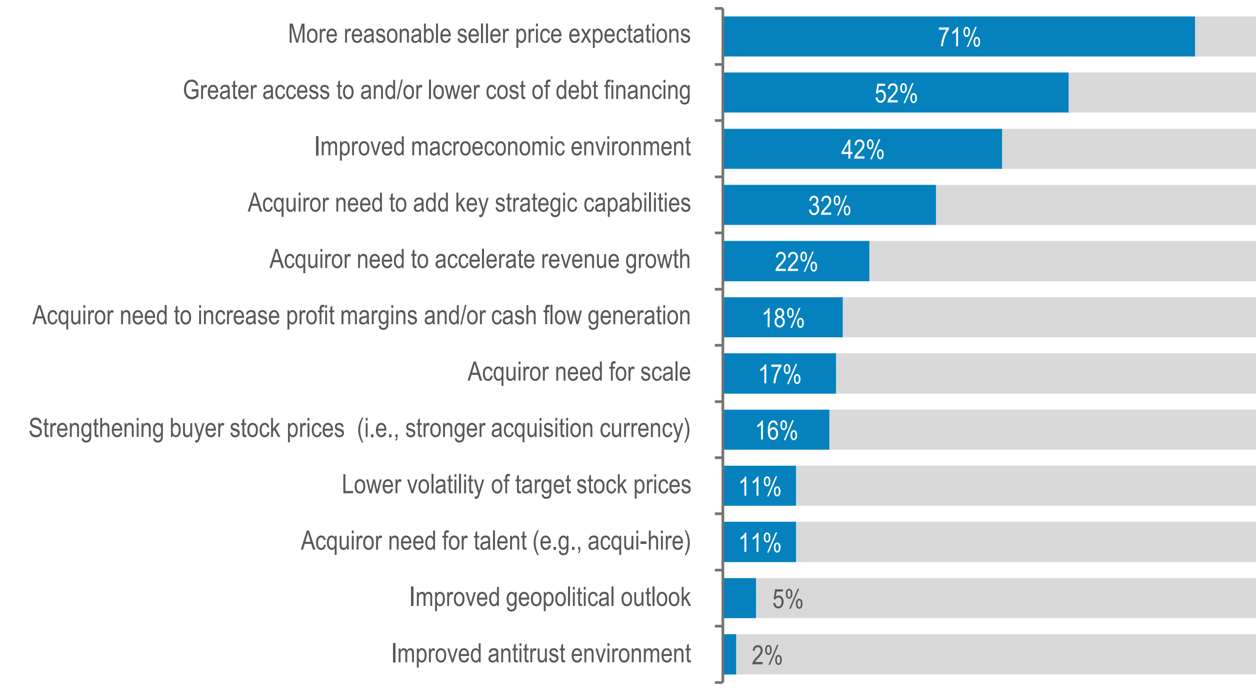
71%

of investors view improved debt financing markets as a key catalyst of M&A activity, versus only

33%

of large-cap public company leaders

Q: ***What are the top 3 factors that will catalyze greater M&A activity in the healthcare services industry in first half of 2023?***



3 Mental/behavioral health, software, and primary care are expected to receive greater investment in 2023 than in 2022, followed by home health and outsourced pharma services. Least likely to receive greater investment in 2023 are facility-based acute and post-acute care and managed care insurance.

Investment Priorities

Almost half of all respondents expect investment in each of mental/behavioral health and software to increase in 2023.[1]

While more than half of private company leaders and investors expect greater investment in software, only 35% of SMID-cap and 33% of large-cap public company leaders agree.

Primary care and home healthcare providers follow, with 43% and 41% of respondents, respectively, expecting greater investment in those areas, with outsourced pharma services next at 35%.

Notably, 67% of large-cap public company executives anticipate greater investment in primary care, versus 43% of respondents overall, which is consistent with recent strategic dynamics, public messaging, and transaction activity.

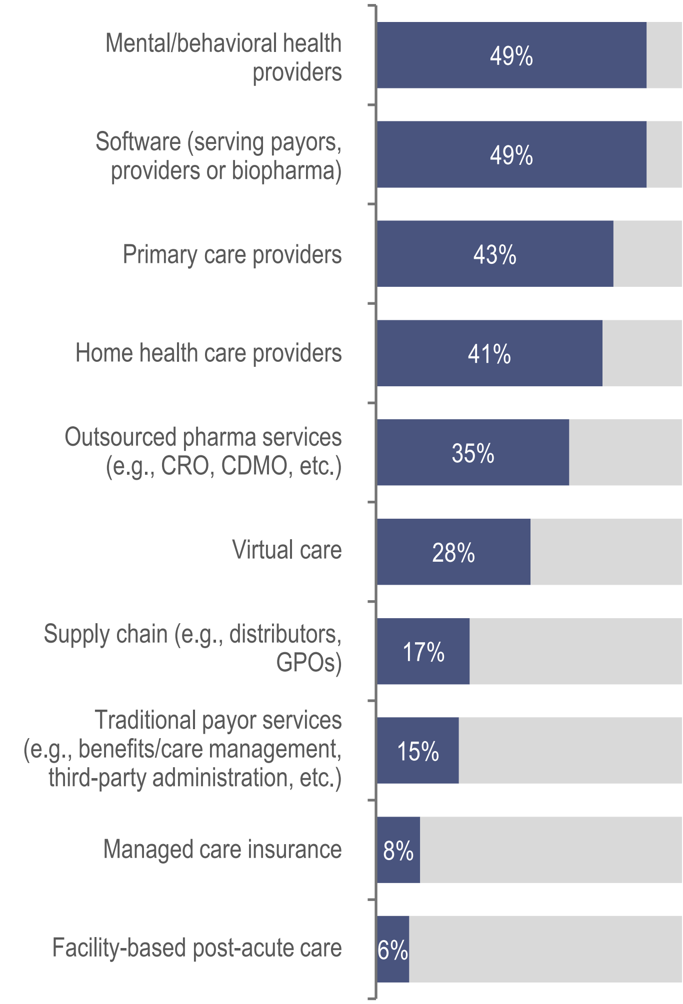
While providers are more bullish than respondents overall regarding the expected level of investment in mental/behavioral health (67% versus 49%), primary care (56% versus 43%), virtual care (39% versus 28%), and acute care (11% versus 3%), they are less bullish than respondents overall about the expected level of investment in home health (33% versus 41%).

Notably, 58% of supply chain/pharma services respondents and 57% of investors expect greater investment in outsourced pharma services in 2023, compared to only 35% of respondents overall.

49%

of respondents expect greater investment in each of mental/behavioral health and software in 2023

Q: ***Which sub-sectors do you expect will receive greater investment in 2023, relative to 2022 (select top 3)?***



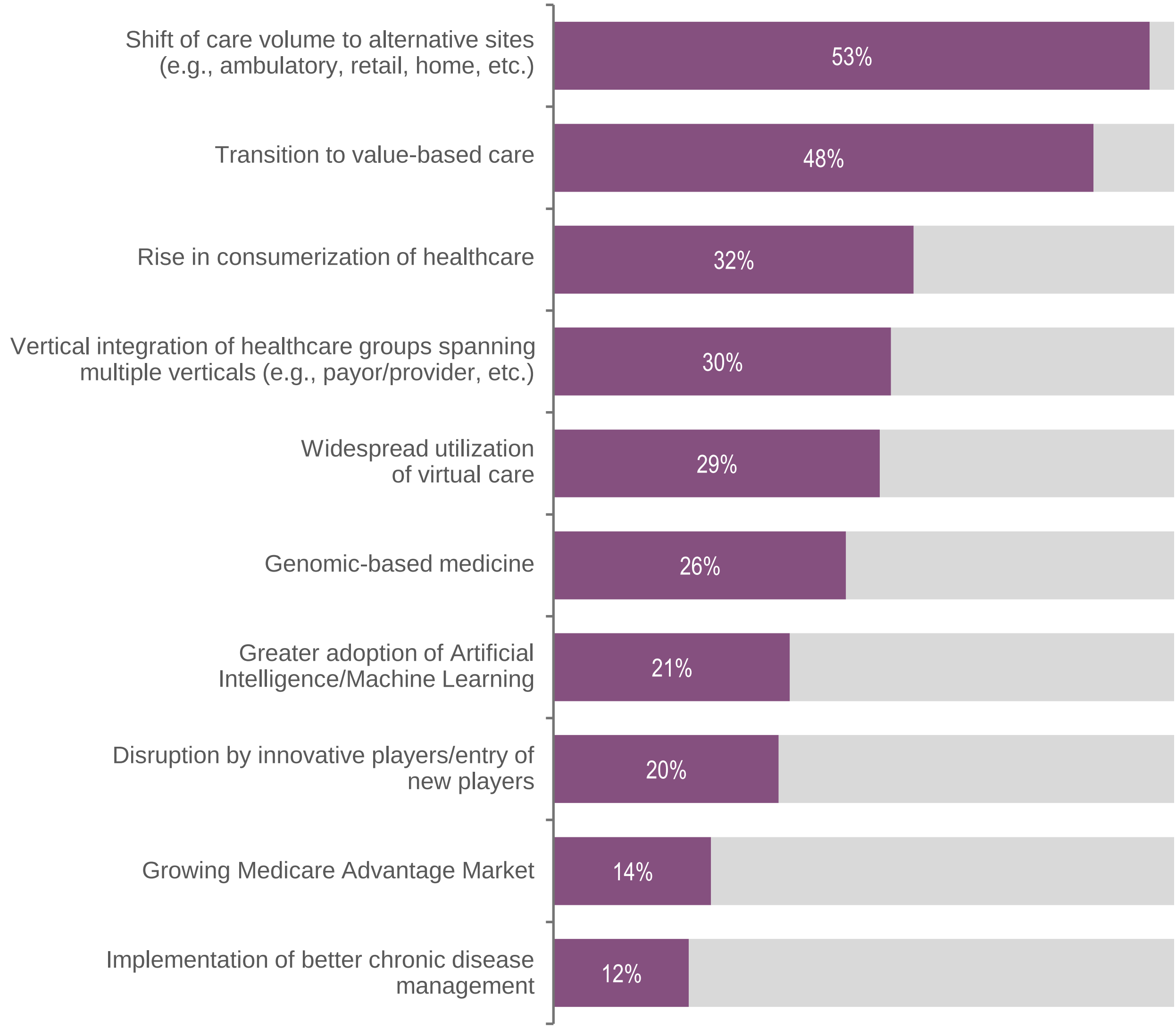
1 Relative to 2022

4 The ongoing shift of care volume to alternative sites and the transition to value-based care are the forces expected to most transform healthcare services over the coming decade, followed by a rise in consumerization of healthcare, vertical integration of healthcare groups, and widespread utilization of virtual healthcare.

Forces Fundamentally Transforming Healthcare Services

Approximately half of respondents believe that the shift in care volume to alternative sites (e.g., ambulatory, retail, and home) and transition to value-based care will most transform healthcare services over the next five-to-10 years.

Q: ***Which of the following forces do you believe will most transform healthcare services during the next 5–10 years (select three)?***



While most investors and large-cap public company leaders (63% and 58%, respectively) expect the transition to value-based care to significantly transform the industry over the next decade, only 45% of SMID-cap public company executives and 36% of private company executives believe it will have a significant impact.

Approximately half of SMID-cap and private company executives believe that the shift in care volume to alternative sites will meaningfully transform healthcare, versus 58% of large-cap executives and 55% of investors.

80% of MCO executives expect the shift of care volume to alternative sites will transform healthcare services.

Approximately 30% of healthcare services leaders expect that rising consumerization of healthcare, vertical integration of healthcare entities to span multiple verticals (e.g., payor/provider), and widespread utilization of virtual care will meaningfully transform healthcare services over the next five-to-10 years.

While only 30% of overall respondents view vertical integration of entities as a key force transforming the industry, nearly half of payor services (50%) and provider services (45%) respondents believe it will be a key factor.

Similarly, while only 29% of total respondents believe that widespread adoption of virtual care will significantly transform healthcare, 40% of healthcare information technology ("HCIT") respondents and nearly 45% of provider and provider services respondents believe it will be a key factor.

Notably, no large-cap public company leader respondents believe that disruption by innovative players or entry of new players will meaningfully transform healthcare services over the next decade.

Only 21% of respondents believe that greater adoption of artificial intelligence/machine learning ("AI/ML") will significantly transform healthcare services over the next five-to-10 years. Nevertheless, respondents believe that areas most ripe for disruption by AI/ML include clinical decision support (58%), population health (49%), risk scoring/quantification (45%), and drug discovery and development (43%).

Whereas

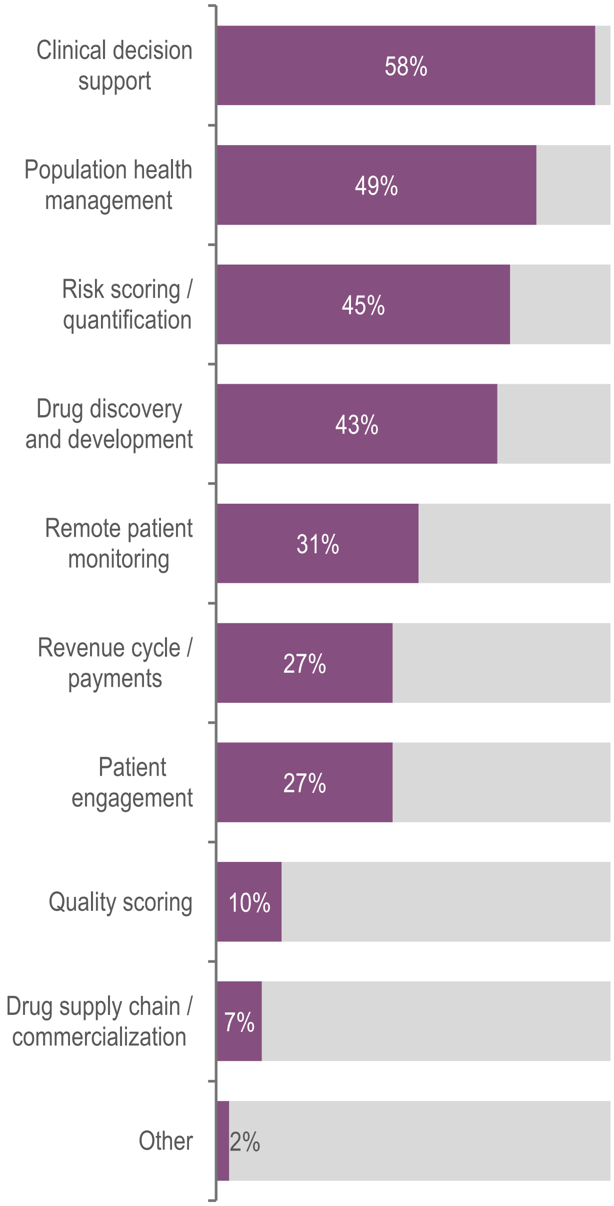
63%

of investors expect the shift to value-based care to significantly transform the industry over the next decade,

only 36%

of private company executives agree

Q: ***What are the top 3 areas most ripe for disruption by Artificial Intelligence/Machine Learning?***



5 Most healthcare services leaders believe that a majority of healthcare payments will be governed by alternative payment models (i.e., value-based care) within the next five years. The transition to value-based care has been most limited by provider preference for fee-for-service reimbursement, suboptimal design of value-based programs, and insufficient data analytics capabilities.

Transition to Value-Based Care

More than 80% of respondents believe that a majority of healthcare payments will be governed by alternative payment models ("APMs") within the next five years (for reference, 41% of payments were governed by APMs in 2020).

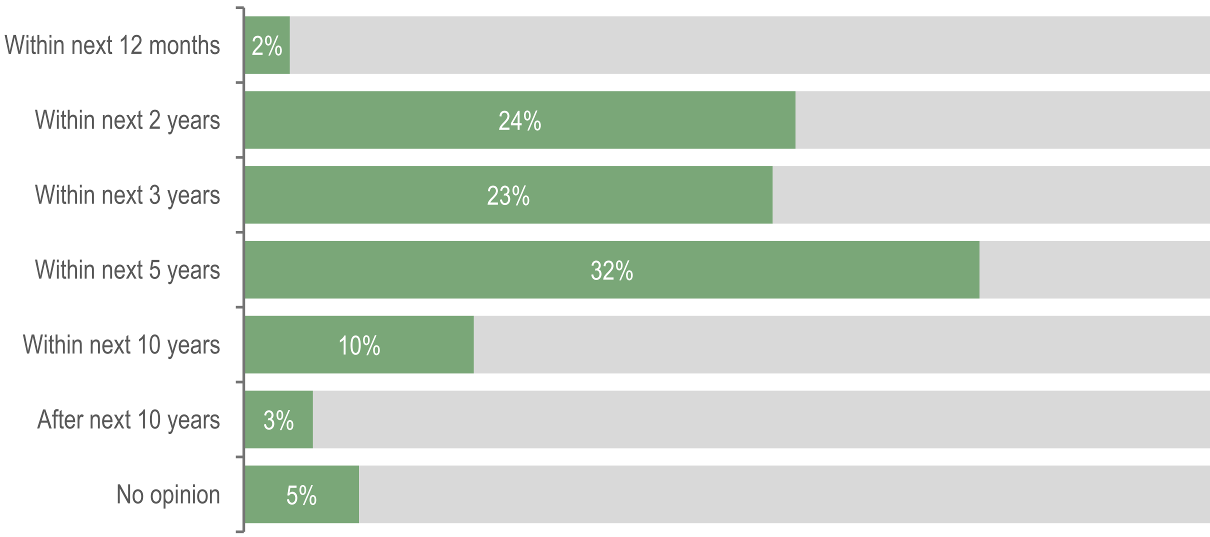
Approximately 15%–20% of SMID-cap and large-cap public company leaders anticipate the transition could take up to 10 years.

Only 3% of respondents believe that it will take longer than 10 years for a majority of healthcare payments to be governed by APMs.

81%

of respondents expect a majority of healthcare payments to be governed by alternative payment models within the next 5 years

Q: ***How long until more than 50% of healthcare payments are governed by alternative payment models ("APMs") (i.e., not merely fee-for-service linked to quality and value)? For reference, 41% of payments were governed by APMs in 2020, vs. 38% in 2019 and 23% in 2015.[1]***



When asked to identify barriers to the transition to value-based payments, 62% of respondents identified provider preference for fee-for-service reimbursement, 47% pointed to suboptimal design of value-based programs (e.g., provider compensation insufficiently linked to outcomes and ineffective assignment of members to accountable care organizations), and 46% pointed to insufficient data analytics capabilities (e.g., inability to measure value created or quantify risk).

1 According to the Health Care Payment Learning & Action Network

Notably, only half of providers believe that provider preference for fee-for-service is a key barrier to the transition to value-based payments.

All MCO respondents and half of provider respondents cite insufficient data interoperability among providers, payors, and/or patients as a chief impediment, versus only 35% of total respondents.

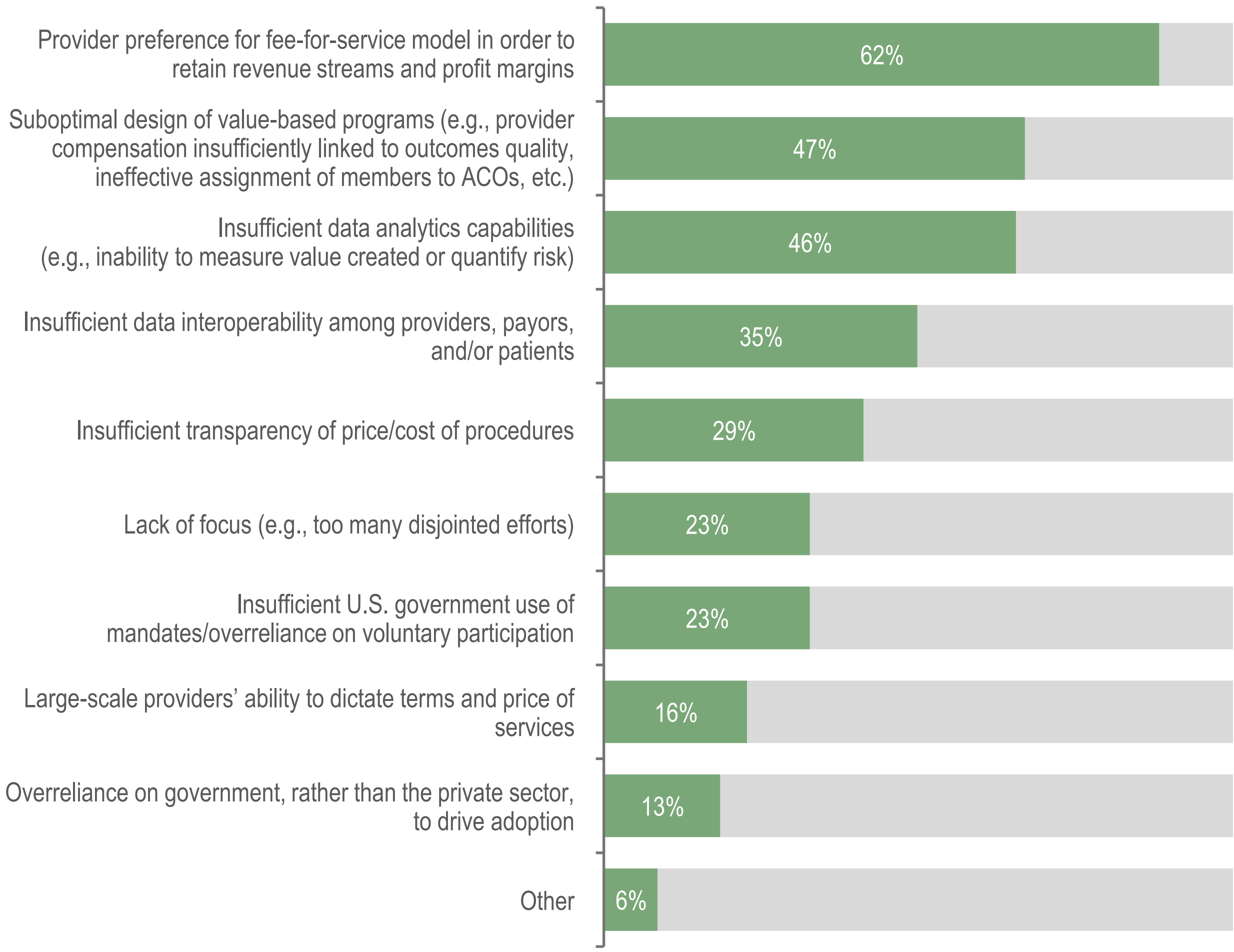
Notably, 60% of MCOs believe that large-scale providers' ability to determine the terms and price of services is a key barrier, versus only 6% of providers and 16% of total respondents, underscoring the ongoing market tension between payors and providers regarding reimbursement.

Investors are particularly focused on suboptimal design of value-based programs (57%) and insufficient data analytics capabilities (55%), whereas only 25%–35% of SMID-cap and large-cap healthcare services leaders share these views.

100%

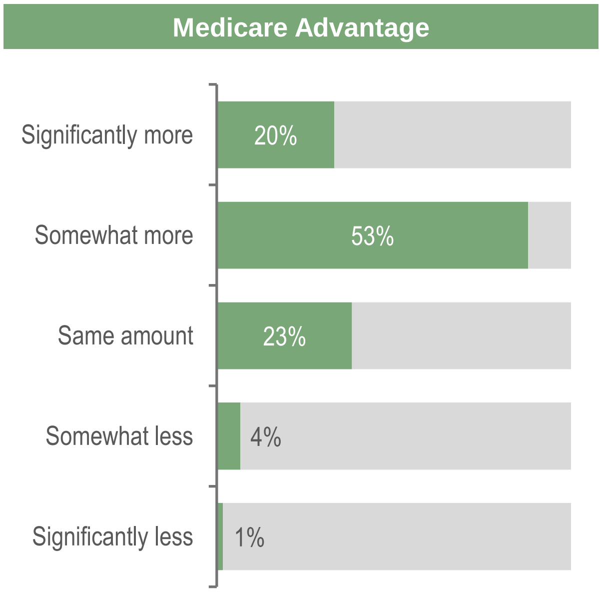
of MCO executives view insufficient data interoperability as a primary barrier to the shift to value-based reimbursement

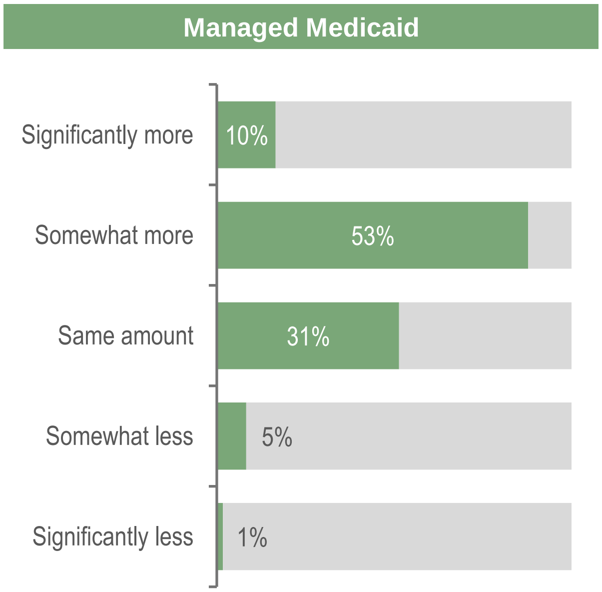
Q: ***What are the top 3 factors that have most limited the penetration of value-based payments to-date (i.e., have impeded the shift away from fee-for-service)?***



Medicare Advantage and Managed Medicaid will continue to play a critical role in value-based care, with 73% and 63% of respondents expecting greater capital to be invested in each of these programs, respectively, over the next decade (relative to today).

Q: ***How much capital will be invested in opportunities related to the following government programs in 10 years, relative to today (select one)?***





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