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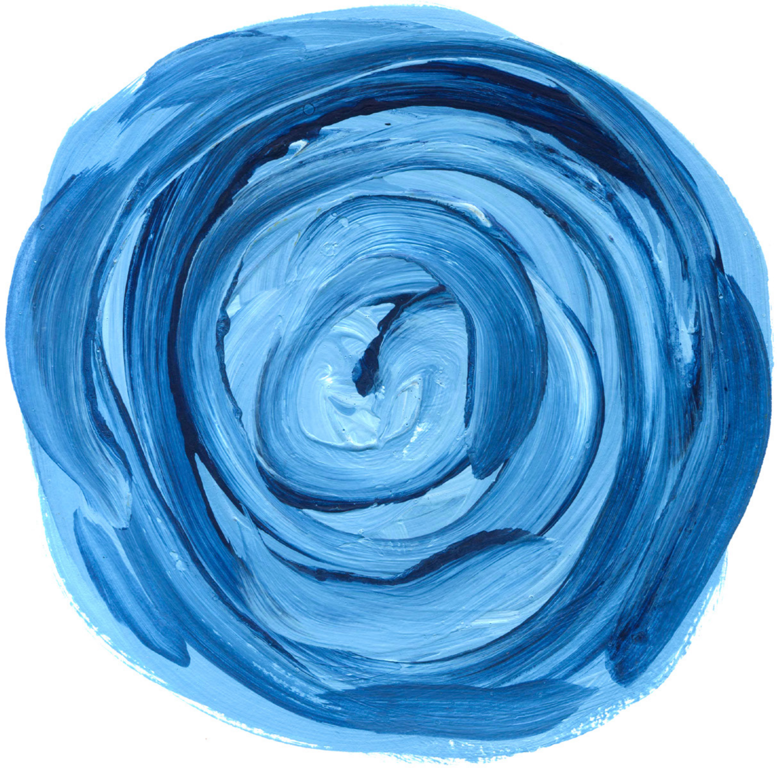

SPACs find new prescription in health care

Consumerism and convergence attract new funding for health techs going public

The health industry has been given a prescription for disruption by a growing base of health technology investors armed with funding from special-purpose acquisition companies (SPACs). The result is a surge in health care SPAC launches in 2021.

High-profile current and former health care executives, along with health technology (health tech) investors, have streamed into the SPAC ecosystem, drawn by a mix of factors, including investor and consumer demand and accelerated growth in areas such as telemedicine, artificial intelligence, wearables, health care robotics, and mental health services.

The hard-hitting pandemic, which caused in-person health care visits to plummet last year, could lead health care organizations and adjacent industries, including retail health, health insurance, and technology, to look for new sources of capital for liquidity or to fuel growth in health tech. These fast-growing health tech companies need capital to pursue new opportunities to engage the emerging health care consumer, and health tech SPACs may be able to provide those companies with up-front pricing, less exposure, and the ability to share forward-looking projections.

SPACs also have the potential to combine complementary businesses that have the capability of delivering higher value and more opportunities for strategic growth. For instance, most recently, GigCapital2 Inc., a SPAC, merged with Uphealth Holdings, a digital care management and digital pharmacy company, and Cloudbreak Health, a telehealth provider, to create a public digital health tech company valued at $1.5 billion.[1] The value of the combined entity, through complementary offerings and channels, may end up being more than the sum of its parts. In 2020, close to 20 SPAC transactions were focused in the health care industry, higher than during the past four years combined.[2] The Deloitte Center for Health Solutions recently analyzed the latest venture capital funding data from Rock Health's Digital Health Funding Database and interviewed 15 health tech investors (venture capitalists [VCs], private equity investors, and corporate venture capitalists [CVCs]) to understand their focus and long-term priorities.[3]

Interviewees said that SPACs require a lot of capital, but in certain cases could make sense as a strategy for some investors.

Interviewees indicated they expect two major trends:

Consolidation among innovators

As innovators with point solutions mature, it is often beneficial for them to broaden their solutions into “full-suite” offerings. Consolidation is occurring through sales partnerships and/or vertical integration. The $18.5 billion merger of Teladoc and Livongo late last year is one example. Teledoc leaders say the new entity will offer “a longitudinal relationship between clinicians and patients, bringing doctors, digital tools and data science together for better health.”[4]

Large industry and tech firms acquiring innovators

Several large health plans, health systems, and life sciences companies are acquiring innovators to strengthen their own internal capabilities and to diversify revenue sources, according to the interviewees. For example, in January 2021, UnitedHealth subsidiary Optum announced the $13 billion acquisition of Change Healthcare. Change Healthcare’s sizable clinical and financial data platforms will complement Optum’s provider offerings, especially around value-based care.[5] Apart from incumbents, big tech companies and large firms from other industries such as retail will also continue to be active M&A participants in their efforts to enter and gain a larger share of this industry.

The current health care market

The recent market is very receptive to health tech IPOs. A record 11 health tech innovators have gone public in the past two years. Interviewees attribute this trend to a combination of factors: The pandemic, as bad as it was, gave innovators an opportunity to demonstrate their value (e.g., remote care, well-being, data and interoperability, drug discovery) more quickly and at a larger scale. Amid economic headwinds, investors saw potential value in health innovation. Interviewees believe the success of these health care or digital health IPOs will push several late-stage innovators to consider going public in the next year or two. In 2020, 33 innovators raised $100 million or more in late-series funding (C+), based on our analysis of Rock Health data.[6]

With health tech SPAC mergers attracting strong valuations over the past six months, the merged entities, many of which were not previously considering public exits, welcome the growth capital and liquidity provided by a SPAC.[7] However, if recent market volatility diminishes institutional investor interest in providing additional capital through private investment in public equity (PIPE) investments, valuations and interest from companies considering a SPAC merger may wane.

As an alternative to the traditional IPO process, SPACs raise public money based on plans to undertake a search for an acquisition target. SPAC management must maintain the IPO proceeds in a trust account until it either “de-SPACS”—merges with a private company, thereby taking that company public—or returns the cash to shareholders if no investment opportunity is identified within the usual 18-to-24-month time frame.

SPAC IPOs were hot last year, with 248 SPACs collecting more than $83 billion from the public markets, a 320% rise in the number of SPACs compared with 2019, and more than the prior five years combined.[8] As of May 13, 2021, another 422 SPAC IPOs had raised more than $134 billion.[9] Given that SPACs go public with no existing business operations, investors are betting on the competence and experience of the SPAC’s management team to deploy capital to situations that have greater upside.

Even as the public market route has opened up considerably, the traditional merger and acquisition route could also accelerate. In the past few years, M&A volume for health tech deals declined slightly before rebounding considerably in 2020.

The SPAC appeal in health care

From a CFO's perspective, the distinguishing (and appealing) characteristics of SPAC mergers include:

Up-front pricing.

While a traditional IPO determines its pricing at the end of the process, SPAC sponsors and the operating company negotiate a price up front, offsetting the risk of market volatility and bad timing. When negotiating with the SPAC sponsor, private companies will need to be cognizant of the financial instruments included in SPAC mergers that often lead to dilutive effects for the owners of the operating company.

Avoiding exposure.

The ability to price the deal in the beginning may be especially intriguing to health tech organizations that may not want to disclose information about business profits and strategies publicly until a deal has been reached. IPOs typically involve roadshows, with CFOs and other C-suite executives courting prospective investors prior to pricing a deal. With a SPAC merger, however, businesses are not obligated to broadly share information until the general terms of a deal have been struck.

Sharing projections.

In a traditional IPO, SEC rules may prevent companies from disclosing future projections in their registration statement or prospectus. But in a SPAC, forward-looking projections may be included in the SEC filing. As a result, CFOs who do not expect their companies to manage a profit in the short term can communicate that to investors in hopes of attracting patient investors. At the same time, those who foresee hypergrowth may capitalize on that trajectory to reach a desirable valuation.

While there may be significant benefits to a SPAC merger, a CFO should recognize that the challenges associated with preparing for the transaction, executing the de-SPAC process, and sustaining the new public company can be formidable. Changes to people, processes, technology, and advisers are often required to meet new challenges related to forecasting, sell-side diligence, accounting and financial reporting, internal controls, tax planning, information technology, and governance.

Endnotes

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7. Swetha Gopinath and Crystal Tse, "SPAC Listing Boom Drives Record $63 Billion January for IPOs," Bloomberg Quint, February 1, 2021.
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