HMi meets... Paul Tomasic

Houlihan Lokey's head of European healthcare Paul Tomasic tells HM*i* where the investment bank is looking when it comes to future developments

Global investment bank Houlihan Lokey has been busy expanding its healthcare coverage group around the globe over the last 12 months or so, hiring a series of experienced bankers and building a new practice within the group to focus on medical technology. In April 2020, it appointed Christian Lunny into its Australia operation, adding Keith Barry in August last year to lead the new practice from San Francisco. Those hires were followed up with the appointments of Paul Tomasic and Andrew Murray-Lyon as head and director of the European operations and, most recently, it announced the recruitment of Jonathan Guskind to the New York office.

HM*i*, caught up with the firm's head of European healthcare, Paul Tomasic, to find out why the focus on healthcare and medtech, what makes the global franchise important and why build it out now.

The following transcript of HM*i*'s interview with Paul Tomasic has been edited for brevity and clarity.

HM*i* **What determined the decision to invest in a global healthcare team?**
Paul Tomasic We are seeing a significant amount of deal activity in middle-market healthcare, driven largely by globally orientated private equity firms.

Given the number and strength of emerging companies and platforms, we believe that activity is sustainable over the longer-term and, from an advisory perspective, very conducive to a global investment banking approach. We now have one of the largest healthcare teams globally, with more than 50 financial professionals, and one of the few than can provide global insights and capabilities.

We see a particularly strong investment case for medical technology and healthcare technology companies where the underlying regulatory, innovation and commercial trends are compelling

Banks that can position themselves in those healthcare sub-sectors, with a truly integrated global team and platform, can really differentiate themselves and capitalise on that development. It's an interesting backdrop.

In an active deal environment, larger investment banks have mostly focused their efforts on the next mega-cap M&A deal and, by and large, have not channelled their resources to invest in middle market advisory. In contrast, a smaller number of firms have taken a long-term view to embed global, middle-market advisory as their core business DNA.

I think it is a really exciting time to be targeting middle-market healthcare with a strong private equity focus.

HM*i* **Why is now a good time, especially with what we have been through with Covid?**
PT Covid has given certain parts of the healthcare market an impetus for growth.

For example, if we look at healthcare technology, you can see that the way care is delivered has changed fundamentally, quickly and materially. The need to interact with patients did not go away during the Covid pandemic and the use of healthcare technology served as a vital tool to bridge potential gaps in care interaction. In a post-Covid environment, I believe that many technology platforms will continue to be actively used given their ability to not only provide more efficient care but, more importantly, better care. This positive backdrop is enabling many technology-driven healthcare companies to grow from being venture-backed into something more suited to middle-market private equity investment.

Similarly, while its more obviously clear that specific sub-sectors within medical technology, such as diagnostics, will experience fundamental demand-driven growth, what may be less noticeable is that other areas of medical technology will also experience strong growth as a result of the Covid pandemic. For example, medical technology able to deliver improved patient outcomes in alternative non-acute settings such as homecare, outpatient clinics and long-term care facilities are likely to emerge with stronger growth profiles.

Moreover, those that deliver improved outcomes in acute settings by means of safer, more efficient and effective outcomes – robotics come to mind - will also benefit.

So, in essence, the Covid situation has turbo-charged interest in companies underpinned by innovative medical technology solutions and this has resulted in increasing interest from private equity looking at the sector with longer-term horizons.

HM*i* **Has this interest translated into greater deal flow?**
PT Yes, there has certainly been a marked increase in deal activity levels since the turn of the year.

That's partly due to reducing rates of Covid infection and a successful vaccine roll-out in select geographies, including the UK.

Moreover, investor sentiment has changed with many private equity firms starting to cautiously increase their focus on emerging trends after the Covid crisis rather than mainly focusing on Covid's impact during the crisis. They are looking

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Head of European Healthare, Houlihan Lokey

Career
Managing director - head of European healthcare,
Houlihan Lokey (Apr 2021–)
Managing director - European head of healthcare,
RBC Capital Markets (Jul 2014–Apr 2021)
Managing director,
Citigroup (Jan 2007–Jul 2014)
Consultant,
L.E.K. Consulting (2007)
Director,
UBS Investent Bank (Aug 2000–Mar 2006)

Education
London School of Economics and Political Science
LLB (1997–2000)
New York University - Leonard N Stern School of Business (1991–1995)
BS Accounting

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for the winners in a post-Covid world.

Against this backdrop, the capital markets have remained conducive to deal making activity and some look to complete transactions before any material tax changes are enacted.

Finally, I would note that there is ample capital in the overall investment environment looking to be put to work in attractive sectors, including higher growth, middle market healthcare. SPACs are one prominent example, but I believe this well runs even deeper as one consider the general fund-raising environment for private equity firms and the overall state of the equity capital markets.

HMi **You mention private equity activity has increased and is looking at the market on a five to ten year horizon. Could you go into a bit more detail on their approach?**

PT Longer-term growth dynamics are always important in any investment, but I believe hold a particular place of importance in investments into the middle market where companies, by means of their innovative product offering or business model, are often disruptively changing the landscape around them.

For private equity investments, the reason I think it's particularly important to look to the ten year horizon and beyond is because those companies will still need to be sold on a growth-impacted multiple after the more typical four-to-five-year investment hold.

Put another way, most investment returns analysis simply don't work if there is contraction in the multiple paid from the time of entry to the time of exit. And the level of multiple paid for a middle market company is most strongly correlated to its future growth prospects.

While it is challenging to gain conviction on a long-term growth thesis, particularly in the uncertain world we live in, the good news for investors in middle market healthcare is that the fundamental long-term drivers of many of these businesses are so compelling from a macro perspective, including demographics, that the case can be more easily made than for some other sectors.

HMi **Given the weight of capital looking for a home and the extent to which other sectors of the economy have suffered during the pandemic, have you seen new types of players appearing, attracted to the growth story in health care?**

PT Yes, we are seeing several relatively newer buyer groups emerging, fueling even more competition for high-quality assets.

First, there is a lot more interest from middle-market US private equity firms in European assets. In many of the healthcare sub-verticals, the US market has evolved and consolidated for a longer period of time. While the underlying health systems are very different as between the US and most European jurisdictions, there are valuable learnings that US private equity players can utilize in assessing European opportunities. In addition, as Europe remains relatively more fragmented in many of sub-verticals as compared to the US, there is often more opportunity to acquire assets and build global platform through follow-on consolidation.

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Secondly, there is a lot of interest out of Chinese private equity funds, including those with offshore capital and/or offshore presence in Europe. We have a seen a significant proliferation of Chinese-based funds with global interest in the healthcare middle-market and these funds are becoming increasingly sophisticated in their technical assessment of companies as well as in their aptitude to execute transactions outside of China and to synergize those investments in their local market.

We've also seen the appearance of traditional infrastructure funds in larger ticket transactions. While their presence in the middle market is less pronounced today, we fully expect that, in time, their investment thesis will extend in that direction. These funds would have invested in major infrastructure projects in the past (airports, toll roads etc.) which appeared relatively safer than many parts of healthcare, but things have changed, and they have been turning their attention to a broader definition of healthcare.

All of this is not to take-away from the continued strong interest we see from well-capitalised, established strategics who actively target the middle-market where growth rates are often high and they can drive significant operational synergies.

HMi **New players, US and China interest, ready money. Is that having an impact on asset prices and expected returns?**

PT In line with historical trends, private equity continues to target >20% returns on their investment, often trying to build in buffers into their calculations for companies where the future cash flows have a higher-risk profile.

However, we are seeing some nuances to this target return profile. For example, for a business with a lower beta, a lower risk profile, the internal rate of return (IRR) demanded will often be lower.

Prices paid and expected returns also depend on the nature of the buyer group. Processes with strong interest from infrastructure funds, who may take a longer investment horizon, result in lower forecasted rates of return.

Some Asian buyers will more readily factor in an Asian listing as an exit for their investment, resulting in a different exit calculation.

As a general rule though, particularly for medical technology companies, the tenet that growth – particularly top-line growth – is the most important factor driving valuation has held from the pre-Covid world.

HMi **What is the impact on deal volumes and deal sizes?**

PT Deal volumes are increasing for private equity and M&A deals, and that activity is most pronounced in the middle market and the lower middle market.

One hot spot right now for healthcare assets in Europe are those companies with EBITDA ranging from US$5m - US$30m EBITDA. These assets are often seen as platforms for multiple avenues of growth, often already underpinned by some type of innovative differentiator in their product or service offering or business model.

Another changing dynamic in the healthcare landscape is the increasing belief that the equity markets might serve as a viable exit strategy, rather than needing to rely on a sale to another private equity firm.

For larger assets, I think the equity markets are going to play greater role in Europe as an exit mechanism as the universe of listed peers expand and as more assets reach size levels that allow for sufficient liquidity in the public markets. Synlab, a product of historical consolidation, is a good example of this dynamic.

HMi What kind of multiples are you seeing?

PT It's difficult to generalise but for good medical technology businesses with strong growth prospects it is not unusual to get into the mid-to-upper teens multiples of EBITDA.

We have seen some assets trade at multiples of over 20-times.

The other thing we continue to see on some platform assets is the ability to sell off of pro-forma or adjusted run-rate EBITDA multiples. In a post-Covid world, we have even seen the concept of EBITDAC emerge in some situations, whereby parties try to quantify the adjustment for the impact of Covid on the business. That has been challenging concept, especially for healthcare businesses where Covid can have a detrimental impact in some situations but a very positive one in others in terms of its impact on a company's financial performance.

HMi Where do you see your time best spent given the investment in the global platform?

PT It is certainly in the middle market. There are a number of key spaces that we are focused on, all with a global team and perspective.

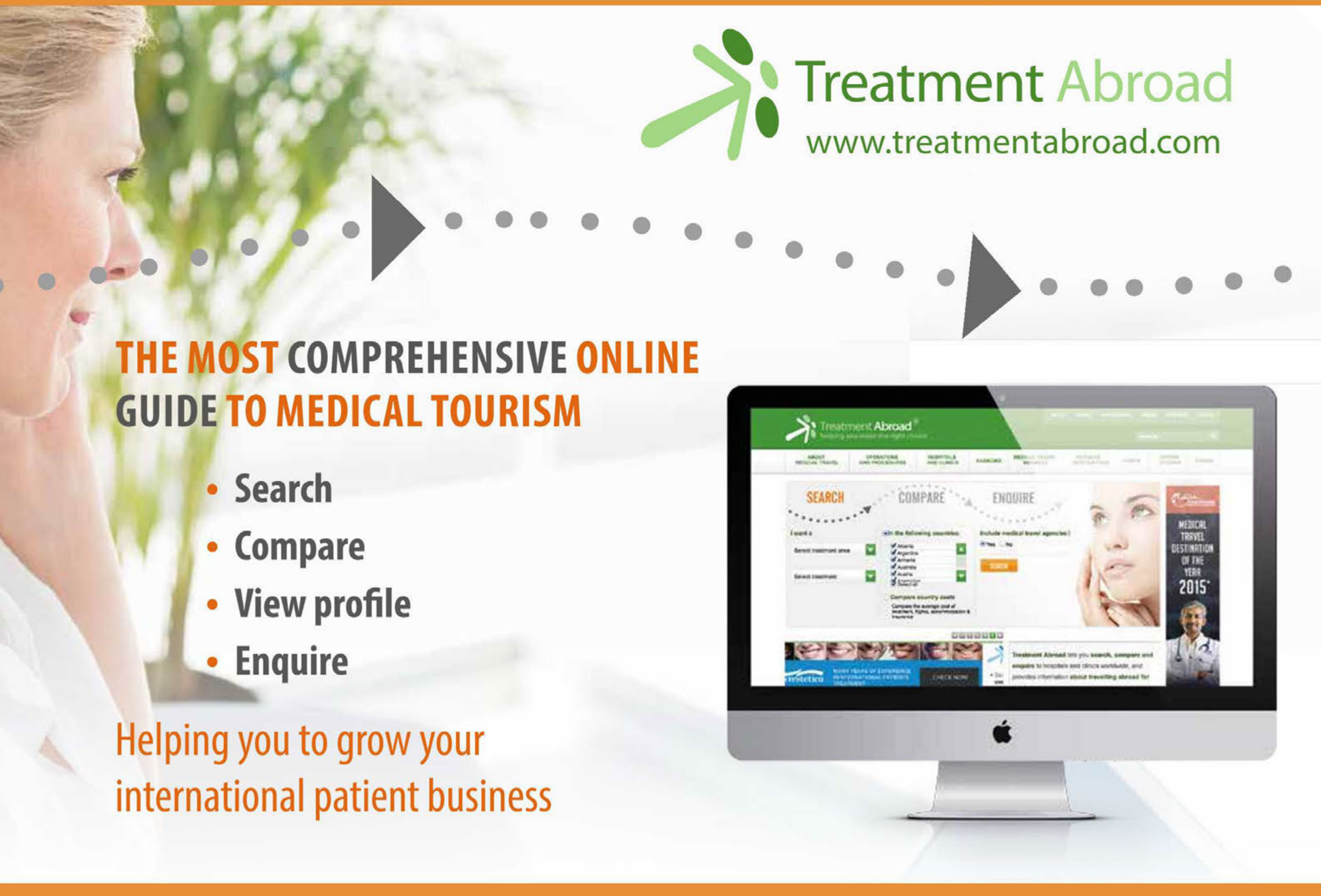
First, medical technology is at the very core of our effort. This includes a wide spectrum of sub-verticals including ophthalmology, dental, patient mobility, surgical supplies and robotics.

Second, healthcare outsourcing which includes medical technology outsourcing as well as pharmaceutical outsourcing. We believe this is a significant long-term trend impacting the sector.

Third, healthcare technology companies, a broad term that includes tech-enabling operators as well as standalone software companies.

Finally, we will target healthcare clinics, in particular those that relate to our broader medical technology efforts previously described. The common link underscoring all of these is areas is that we seek to work with growing, innovative companies – starting from US$5m and above – and working with these companies on a global advisory basis.

A bank specifically targeting medical technology as a top priority in a truly joined up global way is something that we have not yet seen in the market. It is pretty unique and it is a prospect that really excites me.



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