Healthcare Vital Signs

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Hayfin's Head of Healthcare discusses the divergent impacts of COVID on the diverse sub-sectors of healthcare and the ongoing investment opportunity for specialist lenders.

A year into the coronavirus outbreak, with official global cases in excess of 109m and the death toll at over 2.4m — the actual figures are no doubt much higher — hope is on the horizon, in the form of an ever-increasing number of approved vaccines being rolled out. Notwithstanding this prospect of some return to normality at an undefined point later this year, the immediate outlook is less than certain. Case counts continue to rise globally, even if the rate of growth is declining in places, and instead of the almost uniform lockdowns of last spring which provided for a let-up in the summer, we have seen divergent approaches to lockdown at national (and even regional) levels.

Despite this "stop-start" dynamic, healthcare has continued to be an area of relative strength. Our healthcare investment outlook remains positive, both on the performance of our existing portfolio, as well as on the pipeline of new investment opportunities.

The term "healthcare" encompasses a wide array of interrelated sub-sectors. Through the first three months of the pandemic we saw performance of these sub-sectors diverge. In general, we saw stable performance for our pharmaceutical-oriented businesses, which intuitively makes sense as people continued to take their medications. Over-the-counter (OTC) / health and wellness-oriented product companies performed better than expected, amid both a rush to stock up on items that could keep you healthy during the pandemic, as well as the continued functioning of supply channels, whether pharmacies or home delivery services, during lockdown.

By contrast, healthcare businesses relying on direct in-person interaction (such as doctor visits or medical procedures) — we are talking here about physician management practices, orthopaedic device manufacturers, aesthetics businesses — suffered a dramatic downside impact as a result of lockdown measures, which in many cases shut businesses down entirely.

Moving through the back half of 2020, we observed normalisation across the various sub-sectors. Companies within the OTC / health and wellness sub-sector continued to perform well in general, but the spike in consumer sales moderated somewhat as we moved through the year. Interestingly, those OTC business which rely on winter seasonal products — say cough/cold and flu — actually saw their businesses hit in the winter. Social distancing and conscientious hygiene have meant a very mild (to non-existent!) cold and flu season.

At the other extreme, physician management practices and businesses dependent on procedures came roaring back as lockdown measures were lifted. Our informal channel checks across a variety of these businesses suggest that sales volumes in Q4 were approaching (and in some cases exceeding) levels seen in Q4 of the prior year.

How much of this was pent-up demand from H1 2020 being satisfied in H2 2020 versus latent demand remains to be seen as we go through coming quarters. However, we do expect pockets of temporary muted demand for healthcare services through Q1 because of the accelerating vaccine rollout. This counterintuitive pattern is the result of patients feeling "the end is near" and wanting to be vaccinated first before visiting a doctor or having a procedure. But in terms of businesses' longer-term prospects, lockdown provided companies with the opportunity to rethink their cost base, meaning they may have exited lockdown on a more sustainable footing and better able to weather further lockdowns, should they happen.

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The pharma picture has been more mixed. In general, people already on existing medication have continued to take that medication. New script volumes have been slightly more muted, which intuitively makes sense — such scripts are often dependent on doctor or hospital visits, which went down dramatically in Q2 (but, as noted above, are now coming back). And penetration of new drugs was made more challenging by hospitals and physician practices putting restrictions around drug sales representative visits which often drive such penetration.

Interestingly, the converse has also been true — established drugs which were expected to be cannibalised by new products have been able to hang on for longer or are seeing slower declines than anticipated. We expect some of the trends to abate as patients return to doctors and to the hospital for procedures, and likewise we would anticipate script volumes to increase for products used in those milieux. Other trends will continue as social distancing and enhanced hygiene measures place limitations on the physical detailing of drugs by salespeople, meaning sales growth of new products may remain muted going forward.

Healthcare Investing and Outlook

If there has been more normalisation in healthcare as we have moved through the past 12 months, one thing that has been truly exceptional has been Hayfin's pace of deployment in the sector. Our transatlantic team deployed well in excess of €1bn in capital during 2020 in support of a variety of businesses — from pharma, OTC and implants to physician practice management and supportive care. These deals were not the result of COVID, but in spite of COVID.

In a world where healthcare remains on firm footing, our sponsor partners continue to deploy equity capital across the various healthcare sub-sectors and our flexible debt capital is there to support them as they invest in new businesses or seek to expand existing platforms. Furthermore, we continue to diversify our business away from purely sponsor-owned companies, participating in the financing of two publicly traded companies. A robust healthcare M&A environment benefits us not just in getting into investments, but also in being refinanced out of them as well: over the past year we were repaid on two investments when they were sold to third parties.

Our healthcare pipeline remains robust at the beginning of 2021. Already this quarter, we have deployed in excess of €130m across two transactions and have line of sight on an additional c.€500m in potential deployment during Q1.

We continue to see opportunities across geographies, sub-sectors and our investment strategies. Notwithstanding the ongoing uncertainties brought by COVID, we remain cautiously optimistic that the generally positive trends we saw in our business in 2020 will continue to play out in 2021. We believe that a return to some semblance of normality later in the year, a hope brought by vaccine rollout, will provide further tailwinds to the sector.

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