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Financial Trends in Today's Lab Industry

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With the healthcare industry significantly more stable than it was during peak periods of uncertainty caused by the COVID-19 pandemic, mergers and acquisitions activity across the entire healthcare landscape has reached record levels over the last two years and remains very strong in the first quarter of 2022.

The laboratory subsector is no exception, and several interesting trends are driving M&A volume across the entire spectrum of laboratory services and technologies. On a secular level laboratory M&A has been supported by healthy public equity markets providing the largest buyers with access to capital, large amounts of private equity capital seeking investment opportunities, and functioning debt markets providing creditworthy buyers with the leverage to finance transactions. While macroeconomic factors may require that interest rates increase in order to curb emerging inflationary signals, debt capital is still expected to be available to scale, profitable buyers with volumes stable enough to borrow against.

More specific to laboratory subsectors, there are several specific dynamics that are keeping buyers active and potentially creating new sellers. Among the major trends in M&A that Ziegler is tracking:

- ***Buyers Redeploying COVID-19 Profitability:*** After initial business disruptions caused by the short-term shutdown of the in-person healthcare industry, and the medium-term disruption of the nation's supply chain, the U.S. laboratory mobilized in an unprecedented way to scale-up testing for COVID-19. As a result, the laboratory operators that contributed to the COVID-19 testing effort were rewarded with large cash stockpiles, which many are now seeking to deploy that cash through acquisitions.

- ***Health System Partnerships:*** Both Quest and Labcorp have been very active in forging new partnerships with (typically not-for-profit) Health Systems. While these partnerships can take many different forms, there is often a discrete transaction at the heart of the deal. This has appeal to Health Systems that are still trying to shore up their balance sheets in the wake of the pandemic (as well as the impacts of PAMA on their outreach revenue) and provides a route for the buyer to deploy capital and to secure long-term relationships. Key examples include the

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10-state deal between LabCorp and the Ascension system announced in early February 2022, and **Quest's partnership with Mercy**, which closed in June 2021.

- ***Pathology Industry Dynamics:*** Clinical Laboratories are not the only segment of the laboratory landscape witnessing robust M&A activity. The pathology landscape also sees continued consolidation, driven in part by longer-term trends such as a fragmented, aging workforce amid the increasing incidence of cancer and growth in demand for pathology. But the pathology landscape is also seeing new, emerging dynamics such as digital pathology causing the pathology space to rethink business models and, by extension, M&A priorities. The last twelve months have been both more-traditional M&A **(PathGroup's acquisition of Greenville, SC-based Pathology Consultants** and **Sonic Healthcare's acquisition of Dallas, TX-based ProPath)**, as well as activity catalyzed by the emergence of digital pathology **(PathAI's acquisition of Memphis, TN-based Poplar Healthcare** and **Versant Diagnostics' [1] acquisition of Chicago, IL-based Alliance Pathology Consultants).**

- ***Evolving Molecular Diagnostics Landscape:*** Relentless innovation, in terms of both testing technology as well as use cases for the data generated by esoteric testing, continues to drive both M&A and strategic investments in the market segment broadly referred to as molecular diagnostics. **Sema4's January 2022 announcement of its acquisition of Opko's GeneDx** business demonstrates the expectations for growth in lab / hospital / pharma partnerships, and **Roche's January 2022 strategic investment in Freenome** and **Labcorp's December 2021 acquisition of PGDx** are just two recent examples of the well-established trend in R&D via M&A.

Valuations across the laboratory landscape have remained stable over the last several quarters, although they vary significantly from segment to segment. And while valuation trends have remained stable, valuation dynamics have remained similarly complex, with negotiations often factoring in some or all of the following:

- Revenue compression due to differences in sellers' and buyers' fee schedules
- Margin expansion expected from scaled buyers integrating sub-scale sellers
- Payers contracting topics such as future impacts from PAMA or the maneuverings of commercial payers
- Evolving views on the durability of COVID-19 testing volumes, and laboratories' ability to expand relationships to sustain organic growth

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About the Author

Patrick Walsh joined the corporate finance team at Ziegler in 2015 after a multi-year tenure in the laboratory industry. He specializes in mergers and acquisitions, strategic advisory, and capital formation engagements for clients in the healthcare services and healthcare information technology sectors.

Ziegler is a privately held, national boutique investment bank, capital markets, and proprietary investments firm. It has a unique focus on healthcare, senior living, and education sectors, as well as general municipal and structured finance. Headquartered in Chicago with regional and branch offices throughout the U.S., Ziegler provides its clients with capital raising, strategic advisory services, fixed income sales, underwriting, and trading as well as Ziegler Credit, Surveillance, and Analytics.

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