KEYNOTE INTERVIEW

Crossing borders in healthcare

Pharma services is creating cross-border opportunities, but GPs should be aware of regulatory and structural issues at play in different jurisdictions, say McDermott Will & Emery's Kristian Werling and Ellie West

Q What cross-border activity are you seeing in healthcare and life sciences?

Kristian Werling: Much of the private equity activity we see is focused on the subsectors of pharma services, device services and life sciences tools. That often involves finding companies with interesting platforms or solutions in the US and taking them to Europe or Asia, or vice versa. We see that theme playing out time and again because life sciences markets are very globalised.

Ellie West: Pharma services is a broad investment theme, covering opportunities across the lifecycle required to bring a drug to market, from conception to delivery. We have worked with several PE clients who have focused on healthcare and life sciences for decades. Those specialist sponsors have started to be a little more considered and niche when looking at deals, as more generalist funds have moved into pharma services. Alongside companies providing pharma services are similar businesses that serve the medical devices and medical technology community, which are also a target for PE investment.

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Q In which jurisdictions are opportunities emerging?

EW: Hotspots for pharma services have been emerging in Europe. In addition to the traditional hubs in the UK, we're seeing activity in Benelux, the DACH region and more recently in the Nordic region. Some of our clients have also started to look at emerging opportunities in Central and Eastern Europe. Often where we see technology-orientated innovation, we

also see life sciences innovation, especially around the university hubs.

KW: In the US, the traditional hub for pharma services remains around Research Triangle Park in North Carolina. Recently we are seeing more activity out of New York, where a couple of themes are colliding. First, one of the busy investment areas is in so-called pharma commercialisation deals, involving companies that specifically help biotechs bring drugs to market. Those tend to have a strong marketing and advertising component, and New York has always been a hub for that type of talent. Second, New York is becoming a digital health hotspot, and there is a lot of crossover between digital health and IT software solutions for the provider market and the pharma services market.

Q What are the regulatory challenges for firms executing cross-border deals?

KW: The most significant issue in the US recently has been the Inflation Reduction Act, which contains several drug pricing elements that mark a new era in US drug pricing legislation. Our PE clients are analysing the impact of this new legislation and working out which drug products and what types of drug developers will be the winners and losers under this new pricing regime. It is sure to have a global impact because the US is such a significant market for new drugs, creating issues for consideration for any firm investing in pharma services around the world.

The other issue coming down the pike is artificial intelligence, which is a focus for regulators and could significantly impact the delivery of healthcare and life sciences. The EU has already proposed legislation, and US regulators are working on applying existing regulatory regimes to AI solutions. However, AI is an area where regulation is having a hard time keeping up with the pace of innovation, so investors should be aware of evolving regulatory schemes.

EW: We are starting to see issues arise in Europe around the impact of Brexit. Initially, we maintained parallel regulation and requirements between the UK and Europe, but we are now seeing some divergence and the end of transitional periods on the horizon, which means potential for increased administrative burdens and costs for pharma and life sciences companies, and anyone servicing those industries.

We also see government agencies increasing their authority to scrutinise deals and, in the context of a multi-jurisdictional deal, that can be complex given the spread of requirements across different countries. There is now an additional layer of review in relation to foreign direct investment, with life sciences often an area of focus.

Q So-called 'tax-free' equity rollover for business owners is fairly common in US PE deals; what are the considerations around applying that outside of the US?

EW: In US domestic transactions, individual selling shareholders in a private equity buyout can often roll over part of their existing investment into a new structure on a tax-free basis. That has been a key element of structuring US deals for a long time, and, to an extent, it can be replicated elsewhere.

Key to structuring cross-border deals from a tax perspective is to understand the parameters of what can be achieved for local sellers and the management team, and adapt the deal structure to optimise tax efficiency for all. Of course, it's easier in some markets – for example, the UK – while in others it is more difficult to achieve. For US investors looking to build a platform across Europe, it is advisable to get ahead and do the tax work up front to see what structuring options are available.

Q What about management incentive programmes?

KW: The same applies to management incentives. On cross-border transactions, we sit down with clients and ask where they expect their management team members to be located in the future as the company grows. If the plan is to buy companies in the UK, Germany and Southeast Asia, for example, they need to think about a management incentive plan that can be flexed to give the best tax outcomes for individuals in those countries. Sometimes that is not possible, but it is worth doing the work. If you can tell founders and management teams that you have an incentive programme that is going to make them more money in a more tax efficient manner, it is going to help when they are evaluating your bid.

Q What else should GPs consider ahead of deals in new markets?

KW: The other piece comes back to those foreign investment regimes and antitrust approvals. Investors who are new to cross-border transactions and investing in companies that have sales and customers in multiple foreign jurisdictions are frequently surprised by the need to apply for antitrust approvals in multiple countries where a target may not have operations but has customers.

Similarly, foreign direct investment regulatory regimes may require filings and approvals in one or more countries in advance of closing. Understanding what pre-closing filings are necessary can have a significant impact on deal timelines.

EW: Whenever investing outside of your home market, you need to think about the local labour markets – accessing talent pools, navigating the work permit environment, and getting comfortable with differences in salaries and benefits packages, employee rights, and in the way workforces are collectively organised or unionised. ■

Kristian Werling is a partner in Chicago and co-head of McDermott's private equity group, and Ellie West is a private equity partner in London