

Digital Health's Dot Com Moment - Peril and Promise

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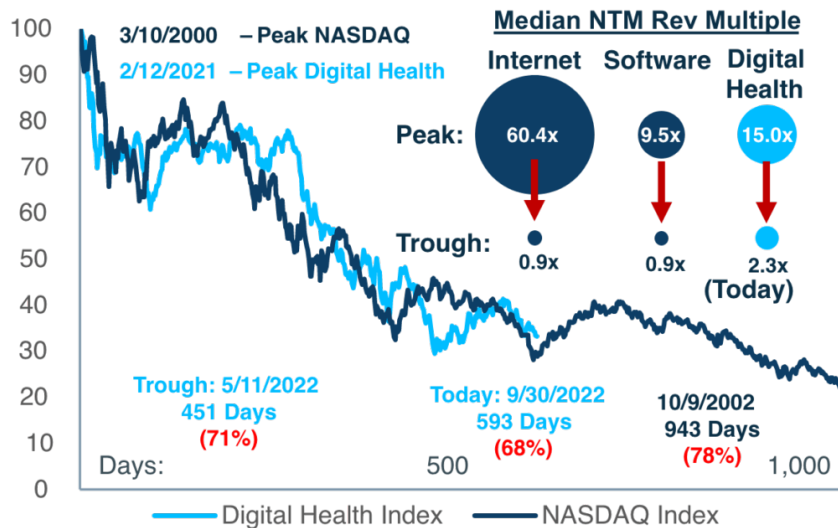
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Revisiting the dot com bubble burst of the early 2000s provides valuable insights when evaluating the current state of the Digital Health market. Over the past decade, the growth of the digital health sector has offered the promise of much needed innovation across healthcare to fulfill the triple aim of improving outcomes, optimizing costs, and engaging the consumer. Despite recent underperformance, the key megatrends at the intersection of technology and healthcare will prevail and support capital inflows and M&A activity in the sector. While historical perspective favors the brave, challenging market conditions persist and foretell a perilous road ahead. As observed after the dot com crash, the recent digital health market downturn offers opportunities for consolidation and sets the groundwork for outsized investor returns.

Digital Health Stock Slide – Eerily Similar to NASDAQ's Plunge in Early 00's

Public digital health companies have undergone a considerable decline since reaching all-time highs in early 2021. The sector is currently trading off nearly 70%, which has led to an erosion of approximately \$100bn in market value. Valuations across digital health have compressed from a 15x forward revenue multiple at the peak to ~3x today. The shape of the decline nearly mirrors the contraction experienced by the tech industry as measured by the NASDAQ after the dot com bubble burst of the early 2000s. There are several similarities:

Digital Health's Rapid Public Market Erosion Mirrors That of the Dot Com Era



Source: FactSet, Capital IQ, PitchBook, Rock Health, and Cambridge Associates.

- Following the dot com era, NASDAQ stock prices plummeted nearly 80% over a more than two-and-a-half-year period before ultimately reaching the trough in late 2002. Valuations across both the internet and software sectors dropped to less than 1x forward revenue during this period.

The digital health industry's recent downturn has closely mirrored the post-dot com tech industry performance with digital health stocks dropping nearly 70% from all-time highs in February 2021, while valuations have compressed to ~3x forward revenue (from ~15x at the peak).

Teladoc, the bellwether of the sector, experienced a stock price decline of over 90% from a peak over \$300 in Feb '21 to under \$30 in May. Just when investors were deeming it safe to ease back into the stock, Q2 earnings announcement resulted in a ~20% decline.

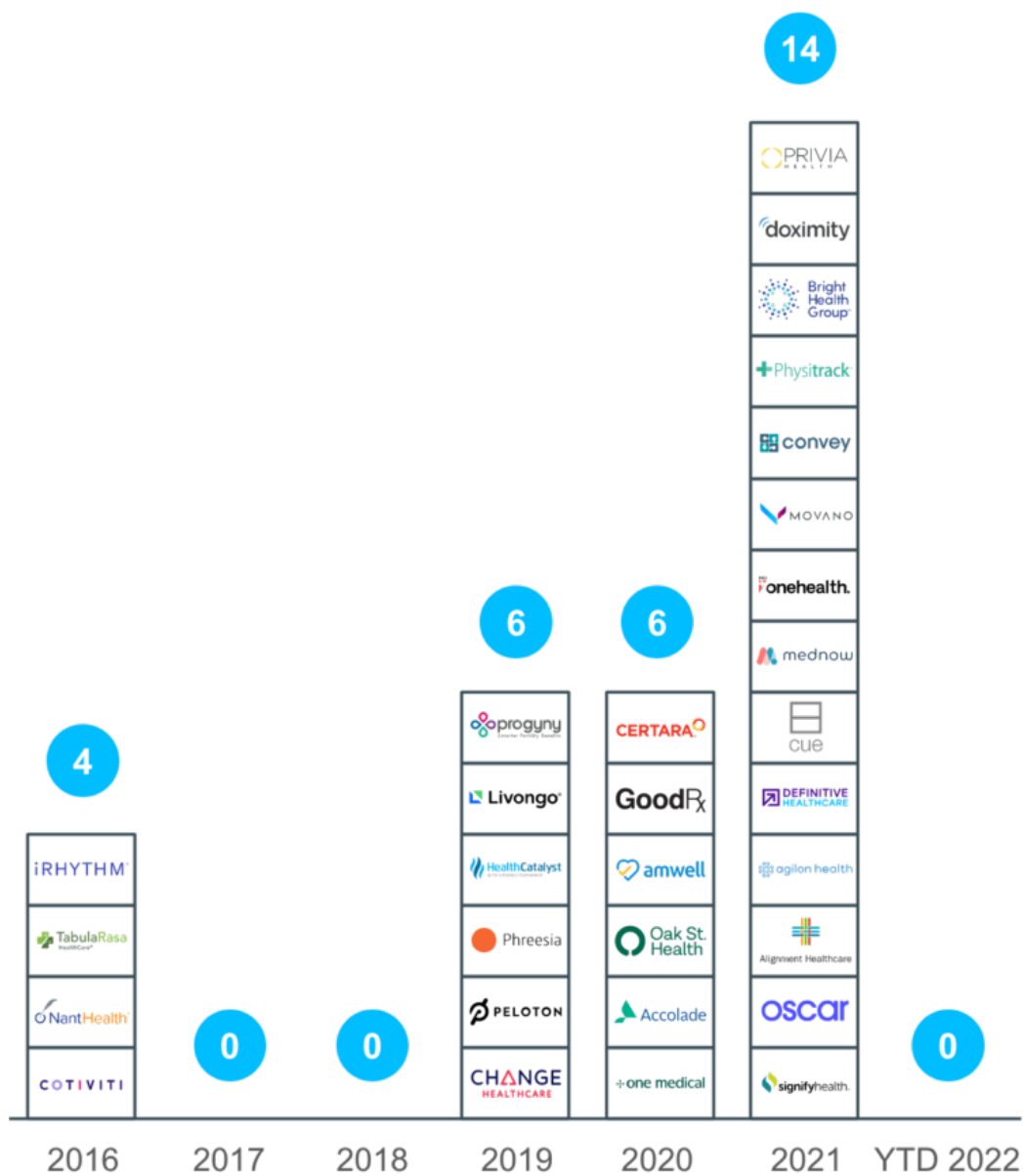
Key Takeaway:

When comparing to the post-dot com era, the sixteen months of time that has elapsed following the digital health market peak suggests that the public market malaise could persist for the next several months, extending well into 2023.

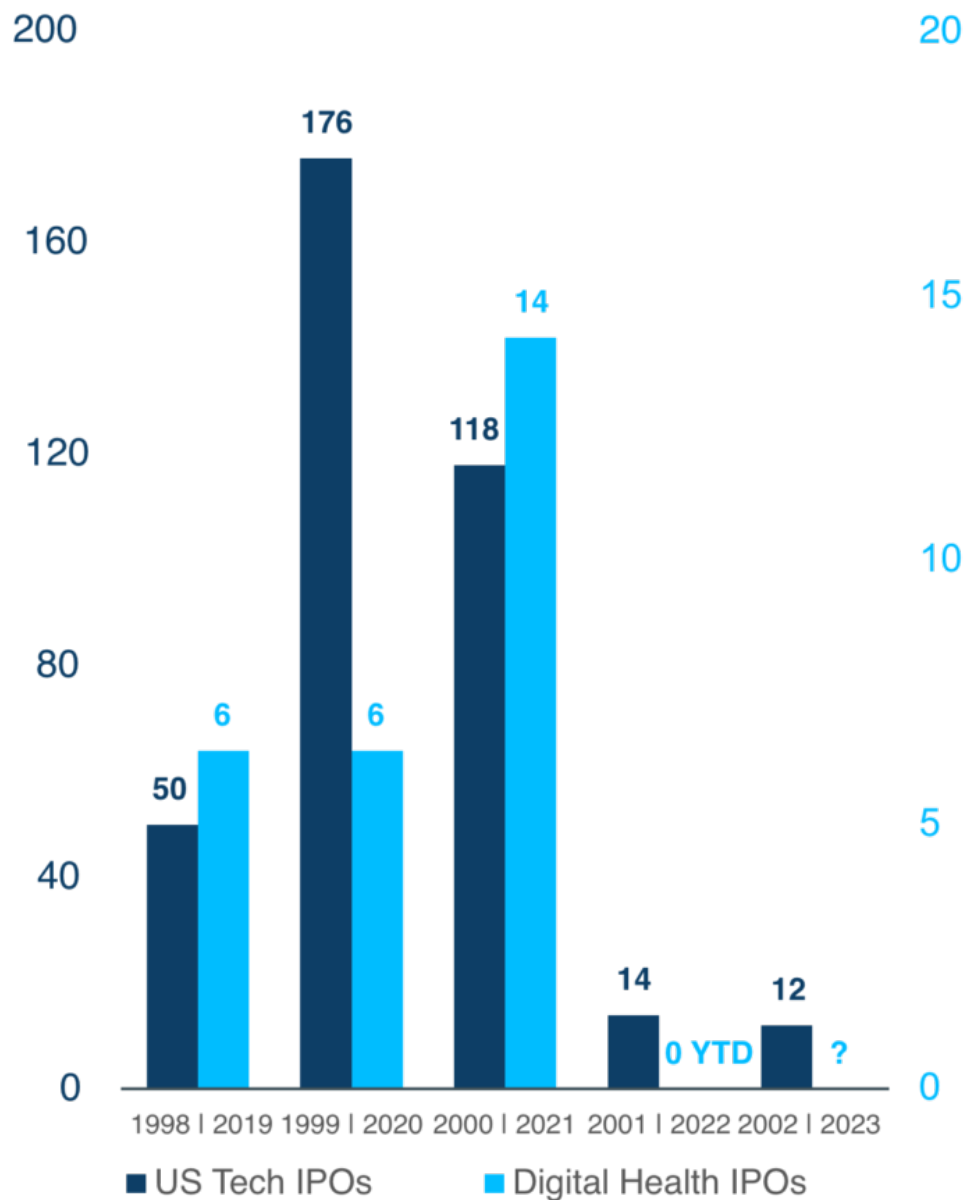
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- The challenging public market backdrop experienced by the digital health sector is further highlighted by lack of new issuances, as IPO activity has grinded to a halt.

After twenty (20) digital health IPOs debuted from 2020 through 2021, there have been zero digital health IPOs during the first half of 2022. Similarly, during the dot com boom, there were 226 Tech IPOs that priced between 1998-1999 before market conditions tightened and only 14 deals were completed in 2000. Current investor appetite for new issuances and, potentially more relevant, valuation expectations of potential issuers have limited activity across the Digital Health sector. Companies considering IPOs have put those plans on hold given the market backdrop and unfavorable public valuation comparables. A large herd of digital health unicorns wait in their stalls, growing into valuations of a bygone boom period.

Healthcare Services and HCIT Public Equity Funding



Digital Health IPO Activity has Stalled, Similar to Fall Off Experience by Tech Sector in Early 2000s

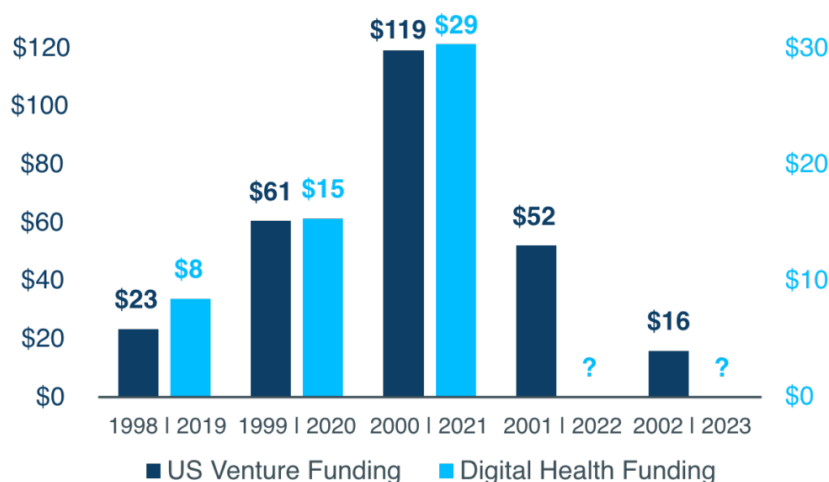


Key Takeaway:

Companies today are pursuing other financing alternatives, including venture debt and insider rounds such as Ro's \$150 million financing in February and Everside's \$164 million financing in July.

- The private financing market across digital health exploded in recent years with more than \$29bn raised in 2021 (up 255% since 2019). However, the **public market challenges have begun to bleed through to the private markets**. With first half financings equaling \$10.3bn across digital health, the sector is on pace for a precipitous drop from 2021 levels. *This drop closely parallels the venture capital market during dotcom era as total venture funding dropped 56% in 2001 to \$52bn after its previous all-time high of \$119bn in 2000.*

The Public Market Implosion Reverberated in Private Markets, Foreshadowing What Digital Health Is Likely to Experience



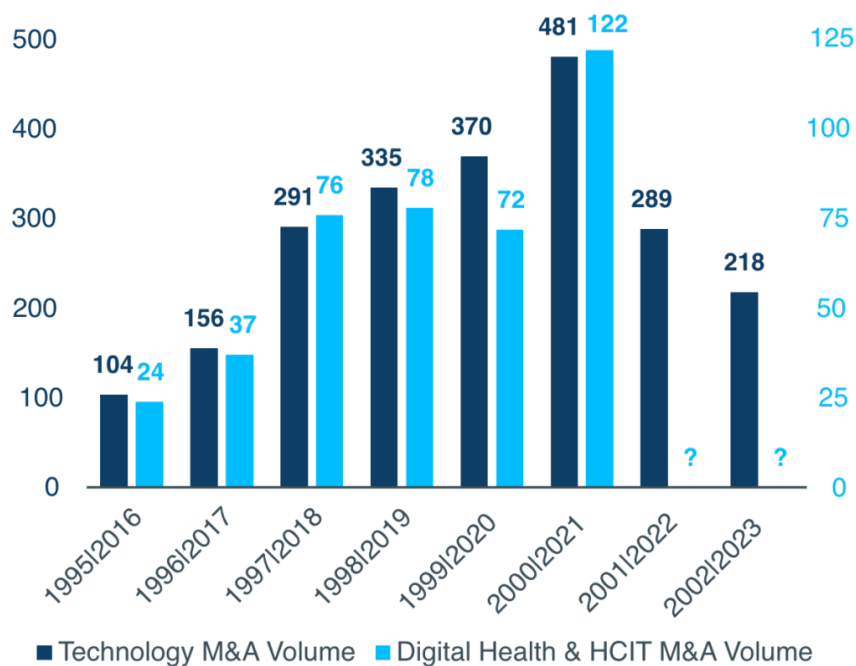
And yet, despite the headwinds, many prominent financings have occurred in recent months, including:

- Brightline's \$115 million Series C in July 2022
- Tebra's \$72 million financing in July 2022
- Carebridge's \$140 million financing in June 2022
- Aledade's \$123 million Series E in June 2022
- Tomorrow Health's \$60 million Series B in June 2022

Key Takeaway:

The expanding base of investors and companies participating in the sector in recent years has created a growing backlog of stakeholders that will be seeking both incremental capital and liquidity in the months and years ahead. This increased competition will likely result in a concentration of deals with the top tier issuers. However, all issuers will experience a more tempered valuation environment in the near-term.

M&A Volume Post-Bubble Peaked in the 24 Months After the Bubble Burst and Remained Elevated



- M&A activity abated after the dot com bubble burst, and a similar phenomenon may occur in digital health as companies – both acquirors and acquisition targets – look inwards before considering inorganic growth through M&A. Aligning valuation will remain a key hurdle to deal activity in addition to governance and integration questions.

Key Takeaway:

We expect an increase in structured transactions and rare all-equity mergers of private companies. Notable examples of the latter include:

- Headspace
 - Ginger
 - Thirty Madison
 - Nurx
 - ShiftKey
 - OnShift
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- For public companies, there are less places to hide. As management teams and Boards face investor scrutiny, public take-private transactions increase. In the first half of 2022, multiple notable take-private deals have already been announced, including:

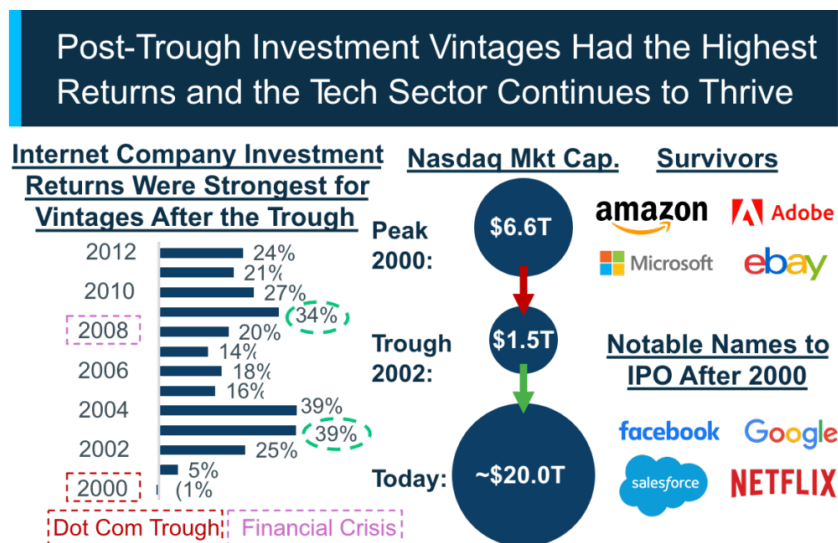
- One Medical acquisition by Amazon
- Castlight acquisition Vera Whole Health (CD&R)
- SOC Telemed acquisition by Patient Square Capital
- Convey Health acquisition by TPG Growth
- Tivity Health acquisition by Stone Point Capital

Key Takeaway:

As boards consider more tempered valuation expectations for the sector and the availability of public capital remains moderated in the near- to medium-term period, companies could be forced to consider take-private and sale transactions as they seek the additional funding and the reduced scrutiny of the private markets.

Conclusion:

In conclusion, despite the current challenging public market environment, the digital health sector remains highly linked to some of the most powerful megatrends of any industry:



Source: FactSet, Capital IQ, PitchBook, Rock Health, Cambridge Associates.

- technology modernization that is nearly two decades behind other industries,
- an alignment of costs and outcomes expected in any market-based business model, and
- a focus on the ultimate customer (i.e., consumer, patient, or member) that painfully befuddles an industry built to help.

As a result, the sector continues to be ultimately well-positioned for outsized growth and expansion in the years ahead. An important fact to remember about the dot com bubble – the internet did not go away. The period of exuberance in the late '90s set the stage for innovation that defined the first two decades of this millennium. Notably for the brave, investment vintages of 2003 and 2004 in the two years following the trough are the highest on record for private internet investment returns. Further, prominent names like Google, Facebook, Salesforce and Netflix all debuted in the public markets after 2000.

It is no wonder then that digital health investors have been able to raise record amounts in 2022 even during this downturn including Oak HC/FT's nearly \$2 billion fund, NEA's reported \$7 billion in new funds, and Andreesen Horowitz's \$9 billion in new funds. The future for innovation in healthcare remains bright.

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