

Navigating Healthcare AI: A Guide for Private Equity Investors

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Published on: January 23, 2024

In the intersection of healthcare and artificial intelligence (AI), there is a promising landscape to invest in innovation, efficiency, and improved returns. As healthcare expenditure continues to surge, driven by an aging population and the demand for sophisticated treatments, AI can address challenges across clinical care delivery, non-clinical processes, and innovation across biopharma and healthcare.

The increasing demand for care, driven by an expanding geriatric population and advances in treatments, has led to a surge in healthcare costs. Almost 30% of the annual \$4 trillion US healthcare expenditure is attributed to administrative activities, with approximately \$300 billion tied to repetitive, labor-intensive processes and inefficient administrative operations. This suggests a significant opportunity for AI to streamline workflows, enhance productivity, and address the burgeoning healthcare costs. AI offers a low-code, no-code approach, making adoption at scale more feasible for organizations of any size and stage of maturity.

Furthermore, patient population demographics are outpacing the replenishment of skilled labor. Simply put, each year, the number of new patients requiring specialty care are outpacing the number of physicians entering and remaining in the workforce. The need for more efficient care is apparent. Leaders recognize this, with 98% of organizations having or planning to implement an AI strategy to stay competitive and efficient.

Accordingly, deal activity in healthcare AI is on a robust growth trajectory. We approximate the industry TAM at \$13 billion in 2023 with an estimated 40.1% CAGR from 2023-2031. Investment and M&A activity are high, evident in the merging of public companies, mid-market acquisitions, venture capital investments, and consolidators investing in innovation.

Despite some signs of conservatism in capital raising, generative AI startups maintain strong valuations, often reaching \$100 million post-money valuation in early rounds. This underscores the

confidence investors place in the transformative potential of AI in healthcare.

To navigate this emerging frontier, Leerink Partners has developed a proprietary framework that codifies enterprise and consumer use cases across clinical, non-clinical, and BioPharma domains. This comprehensive framework identifies applications in Electronic Health Records (EHRs), Devices/Diagnostics, Providers & Care Delivery, Consumer-Driven Care, Payers, Providers, Workforce Management, Patient Access, Drug Discovery & Research, Development, Commercialization, Pharmacy, and Distribution.

When considering AI solutions, understanding the distinction between predictive and generative AI is crucial for cost and complexity containment. Companies should focus on what steps within a work flow require improved efficiency or insights, where complexity hinders quality care delivery, and how technology will ultimately change the organization's headcount and employees' roles. Addressing potential biases in generative AI models and identifying areas where human involvement in the loop will remain critical for effective care delivery.

Investing in AI platform opportunities or for add-ons are generating positive impacts on the bottom line, and for overall portfolio returns. Sellers with AI-enabled solutions are experiencing higher valuations, with a significant increase in transactions involving AI enabled offerings. Operators are demonstrating strong financial results within a short implementation window, driven by a cash-conservation mentality and a focus on immediate value in automation and cost savings. Buyers see opportunities to build capital-efficient companies with innovative technologies, making AI solutions a high demand asset for future exits.

Leerink has developed a mini-series on our perspectives on AI across the Healthcare Industry. Over the next several editions, we will cover sector specific market dynamics, the strategic and financial value of implementing predictive or generative AI tools, and the comprehensive use cases to consider. For additional discussion on our private equity investment framework for Healthcare AI, please reach out to Opal Joshi at opal.joshi@leerink.com and the HealthTech team for our perspective on Healthcare AI for Leerink Partners.

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