



OBERENDER



Trend Report – M&A in the Hospital Market 2020

Industry trends in Germany

The M&A trend report provides a sound overview of transactions in the hospital market



Background

- The German hospital market is an attractive and challenging environment for M&A activities
- The **trend report is addressed to:**
 - hospital owners,
 - strategically working managers in hospitals and
 - investors who see a strategic option in the hospital market to (further) engage.
- The **trend analysis**
 - provides an overview of M&A activities in the hospital market,
 - shows and evaluates developments and
 - provides solution-oriented options for action for different market participants.
- The **observation of the transaction market** includes both a quantitative analysis of market movements and qualitative assessments of what is happening. In addition to the number of transactions, the focus is also on clustering and patterns.
- The **M&A database of Oberender AG** provides the basis of the quantitative analyses. Transactions from 2012 to 2019 on the German hospital market are recorded. The database is based on own research and is regularly updated and maintained through market screenings.
- The **analyses** of the hospital market and M&A activities are supported by the comprehensive databases of the Oberender Research Institute and our subsidiary BinDoc GmbH.

Due to numerous federal political activities the transaction market remains on the move

Management summary



- Numerous **legislative changes** are increasingly restricting entrepreneurial activity and putting growing pressure on hospitals.



- This situation requires **new business models** as well as a strong focus on employer attractiveness. Further market consolidation is expected. The concentration process in the hospital landscape intensified again in the first quarter of 2020.



- Among other things, artificial intelligence and the evaluation of big data opportunities open up new fields for M&A activities.



- The **role of private investors** is still viewed critically in politics and the media and could result in increased transparency requirements.
- With regard to **merger control** in the hospital sector, the 10th amendment to the ARC¹ could result in slight changes.
- Comparatively high EBITDA multiples are applied in the healthcare sectors.



- Since 2016 a relatively high **transaction volume** can be observed with a peak in 2018. In recent years, the market has been dominated by transactions involving the same carrier. North Rhine-Westphalia, in particular, was the focus of transaction activity.



- **Sold hospitals** can be characterised by a number of key features such as bed size, ownership (legal entity), EBITDA margin or debt ratio. The distribution of hospitals corresponds to the transaction volume of the past years and is concentrated on the western states.



- **Oberender expert opinion:** The COVID 19 pandemic is increasing uncertainty in the system. For 2020 and 2021, we therefore expect increased transaction activity in the hospital market.

1) Act against Restraints of Competition

Numerous legal changes further restrict entrepreneurial activity



Developments in the hospital market

Challenges

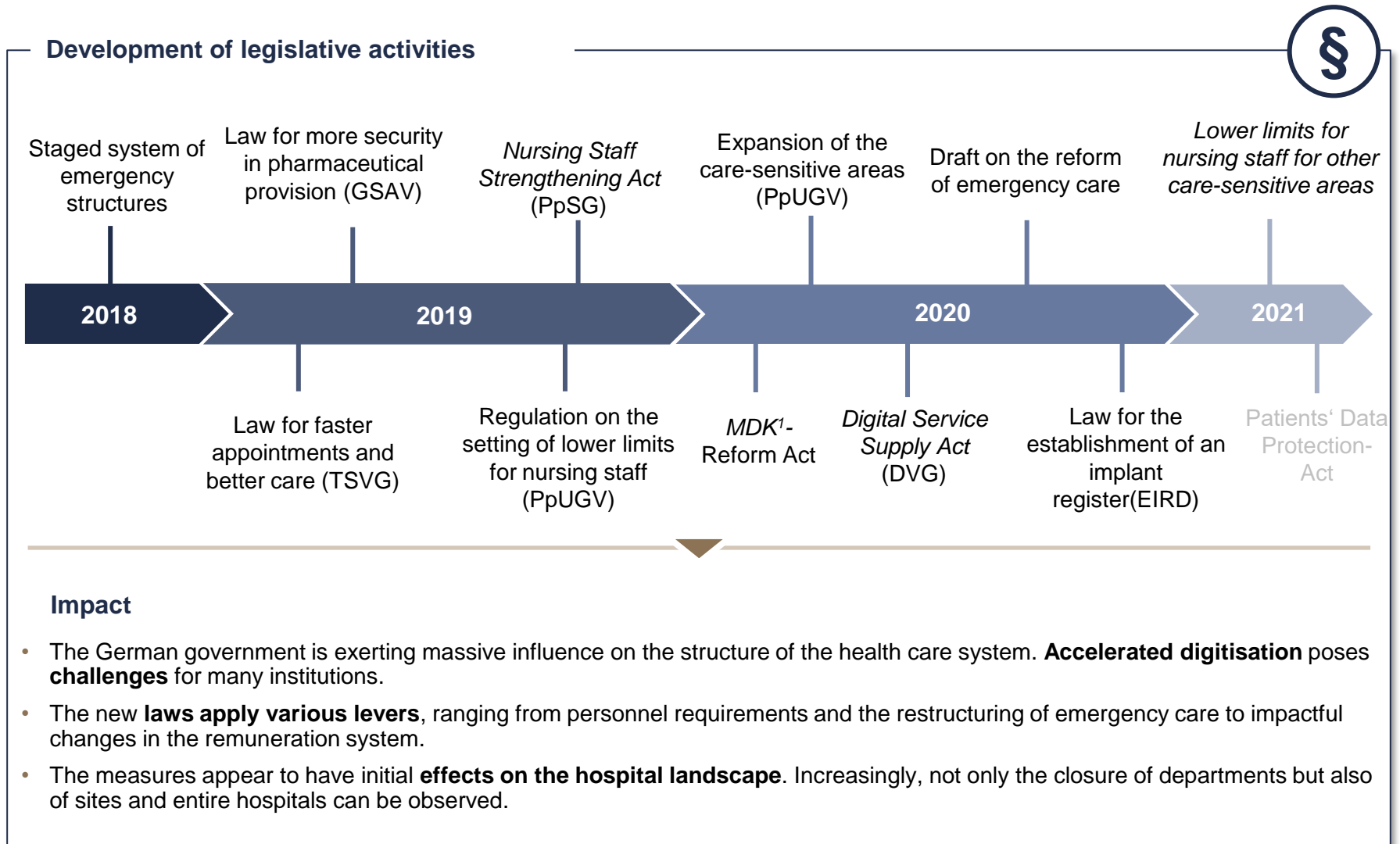
- In recent years, **laws** have been introduced with a high frequency - many measures were immature and require corrections.
- Further **major legislative changes** with serious effects on the hospital market have been announced.
- Additional stricter regulations in the area of **minimum quantities¹** and **lower personnel limits** are to be expected.
- The legislator is placing greater importance on the **expansion of digital structures**.
- The **search for qualified personnel**, also in the administration, is becoming more and more complex, although there are differences between regions and professional groups.
- The **demand for fundamentally new care structures** is growing, as many patients are treated in the wrong place in the healthcare system.
- The medium and long-term **effects of the COVID 19 pandemic** on the hospital sector are not yet fully predictable.

Consequences

- Hospitals are under immense pressure to **implement new laws quickly** and are often unable to assess the consequences.
- The **rising deficits**, the new challenges posed by legislation and the **growing shortage of skilled workers** will increase the **pressure for consolidation** for all types of ownership.
- Hospitals with outdated IT structures and data protection mechanisms expect high costs for unavoidable **investment needs**.
- The digitisation of workflows and structures in hospitals offers **efficiency potentials**.
- The battle for **qualified workers** will increasingly lead to **individual employment contracts** regulations and **higher wages**.
- Hospitals have to increasingly adapt their **service portfolio**.
- The interaction of the different challenges will force hospital owners to make **serious cuts** and fundamental decisions on **future strategy**.
- The COVID 19 pandemic is likely to worsen the economic situation of many institutions.

1) Applies to selected elective inpatient services, where the quality of the treatment outcome depends on the quantity of services provided

Hospitals are under strong pressure due to intensive legislative activity



1) Medical Service of the Healthcare Funds/Insurers

The situation requires new business models and a strong focus on employer attractiveness

Trends in the German hospital market (1/2)

Business models

Hospitals will adapt their **business models** to the individual requirements of the regions and expand **intersectoral care offerings**.

- Through the remuneration system, the legislator is also forcing ever more **extensive outpatient treatment services** that can no longer be provided profitably in inpatient care (e.g. reform of § 115b SGB V).
- Since appropriate **outpatient structures are often lacking**, hospitals themselves must take action to fill these gaps, whether through networks or their own facilities for outpatient surgery, medical care centres or intersectoral health centres.
- The **services remaining** in hospitals are becoming increasingly complex and require the **bundling of specialist expertise** in highly specialised centres as well as the formation of digitally networked partnerships to ensure medical excellence.

Professionals

Hospitals must take a closer look at their **image as employers**.

- Due to the rapidly ageing population, the **shortage of skilled workers** will continue to worsen dramatically in the coming years despite a gradual increase in the retirement age.
- Hospitals, especially those in public ownership, must become more **active, flexible and creative** in order to attract and retain qualified staff.
- **Novel business models** in different sectoral settings also offer opportunities for further education and training and for increasing the attractiveness of employers.

Health policy increasingly relies on artificial intelligence and the evaluation of Big Data

Trends in the German hospital market (2/2)

Digitisation

Digitisation in the German healthcare system is being promoted by initiatives on the part of the Federal Government:

- For a long time, the digitisation of the health care system in Germany was neglected. The Federal Government increasingly sees the benefits of **artificial intelligence** in the diagnosis and treatment of patients. The BMBF¹-funded "Cancer Scout" project, a pre-screening of tumour cells using AI, is one example.
- The **Digital Service Act** is intended to improve digitisation and innovation in the health care system, among other things by increasingly integrating digital health applications into the treatment processes.
- Due to increasing digital networking, topics such as **IT security and data protection** are moving into focus, especially since mistakes can result in serious costs, loss of reputation or penalties.

Big Data und „personalised“ medicine

Due to the **growing possibilities in modern diagnostics and the evaluation of Big Data**, more and more drugs and therapies are being further individualised:

- Data evaluation is becoming cheaper and larger data sets can be evaluated.
- The field of **genomics** in particular is becoming more important. An increasing number of people are having their genome analysed to identify potential health risks.
- Due to the growing promotion, also by the Federal Government, and the rising representation in the remuneration system (e.g. Liquid Biopsy), **Germany is a good location for AI in medicine**.
- Service providers can only serve this market if they have the appropriate **know-how**, since the demands on implementation and the associated logistics are also increasing.

1) BMBF = Federal Ministry for Education and Research

The economic and regulatory framework forces the hospital market to further consolidate

General conditions

- Shortage of doctors and nurses
- Inadequate funding
- Insufficient interdisciplinary care
- Overcapacity (beds and hospitals)

	# hospitals in GER	Beds (thousand)	Bed reduction	Utilisation	Ø length of stay
2000	2,242	559.7		81.9%	9.7
2005	2,139	523.8	-6.4%	74.9%	8.7
2010	2,064	502.7	-4.0%	77.4%	7.9
2015	1,956	499.3	-0.6%	77.5%	7.3
2016	1,951	498.7	-0.1%	77.9%	7.3
2017	1,942	498.2	-0.3%	77.8%	7.3

- The decreasing number of hospitals according to official statistics is not the same as the closure of hospital sites.
- The bed reduction indicator is more meaningful.
- Hospital occupancy rates have been stable since 2010.
- Competition is increasing between the remaining hospital operators.

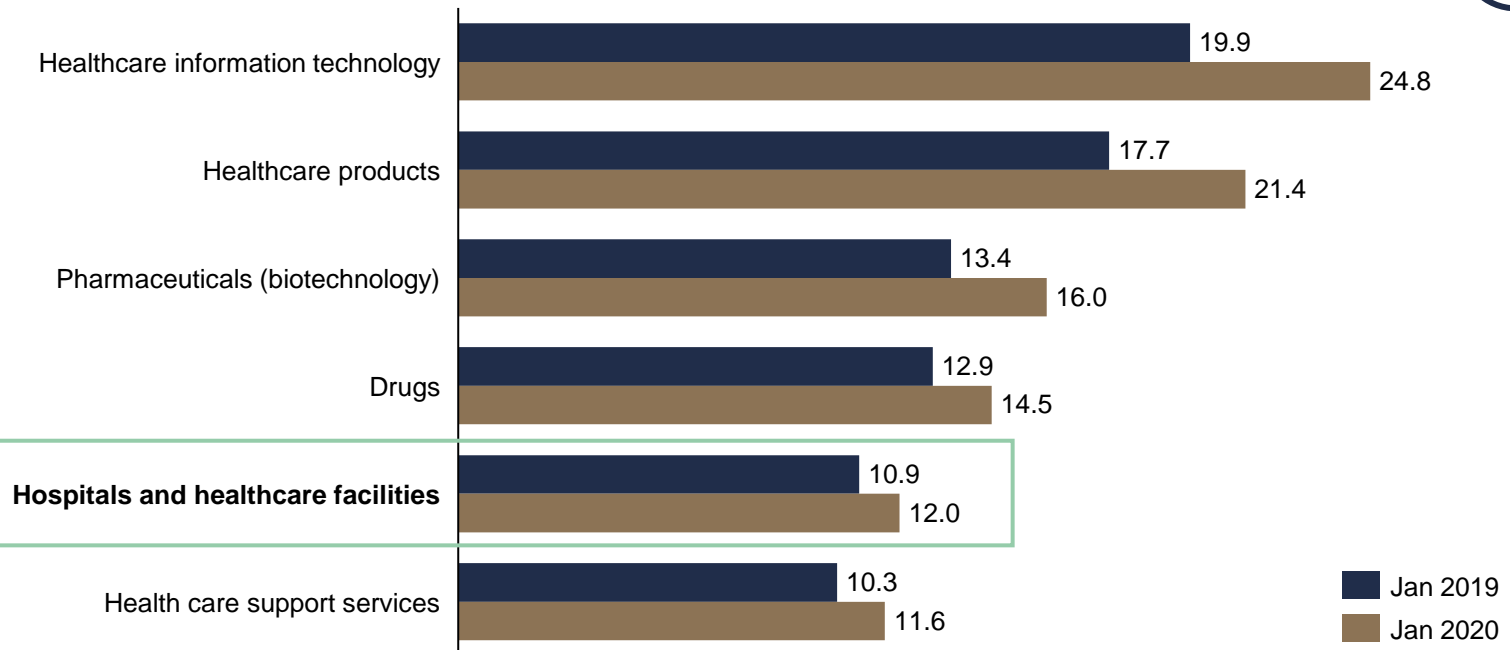
Efficiency pressure despite consolidation

- **Services must** be provided more **economically** as expectations increase.
- **Process optimisation** in many facilities still offers potential for greater efficiency.
- A further problem in many hospitals is the **lack of management competence and capacity** at first and second management levels.

Healthcare multiples have increased in all sectors worldwide compared to the previous year



Average EBITDA multiples in healthcare - worldwide

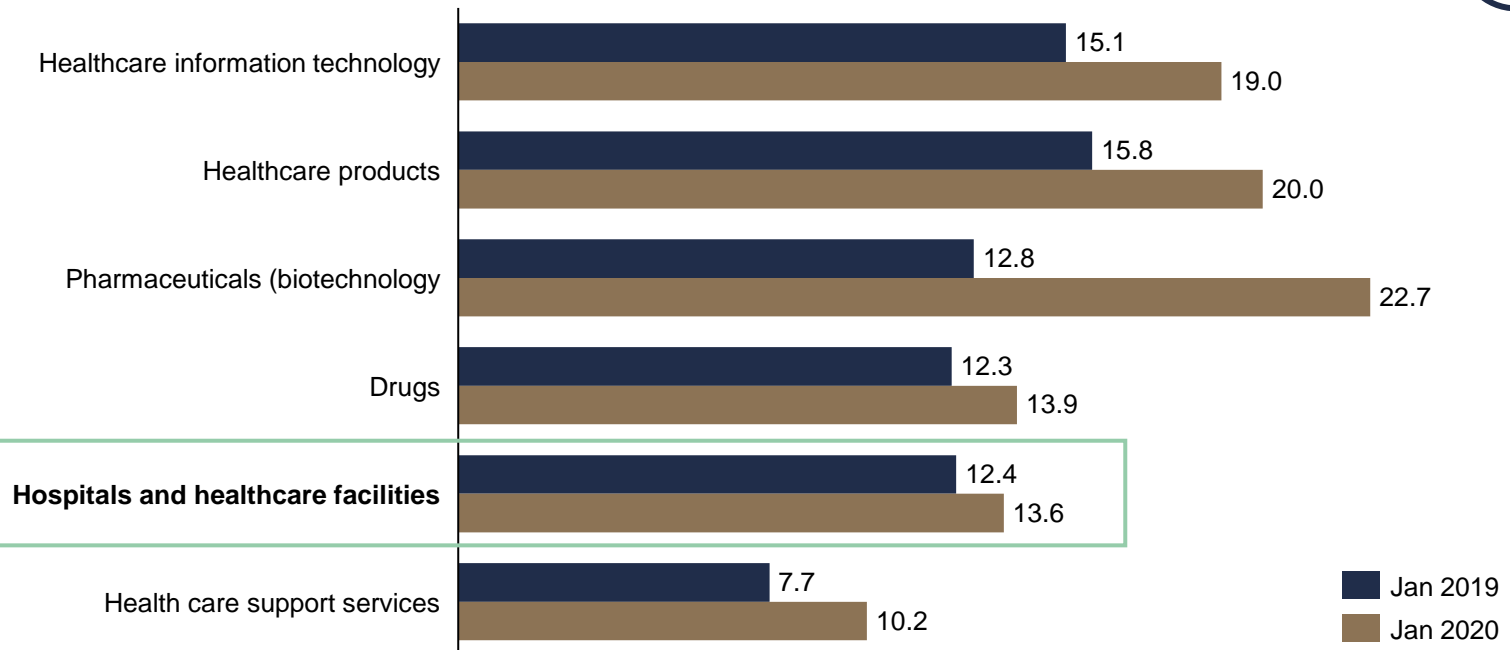


- In January 2020, the multiples are between 11.6 and 24.8.
- Compared to other industries, higher multipliers are sometimes applied in the health care sector.
- Within the health sector, the level of the multiplier varies according to the sector. The highest Ø valuation multiple is in the healthcare information technology sector with 24.8.

The worldwide trend of rising multiples can also be observed in the average EBITDA multiples in Western Europe



Average EBITDA multiples in healthcare – Western Europe



- In January 2020, the multiples are between 10.2 and 22.7.
- Within the health care system, the level of the multiplier also varies in Western European countries, depending on the sector.
- Contrary to the global distribution, the highest Ø valuation multiple is recorded in the pharmaceutical sector (biotechnology) with 22.7. The change in this sector is also above average, whereby individual transactions can also influence the values, in some cases considerably.

Transaction activity in the outpatient and inpatient sector will further change the market structure in Germany



Market structure

Acute inpatient market

In **2018** there was a peak (n=31) in transaction volume with a slight downward trend in **2019**.

Furthermore, transactions between hospitals with the same ownership/legal entity (e.g. public, private) are particularly conspicuous in the area of non-profit organizations and associations. Due to the market structures, market consolidation is concentrated on the federal states of western Germany.

In comparison, there were more mergers in the public sector in 2019. More mergers are expected due to federal policy requirements.

Outpatient market

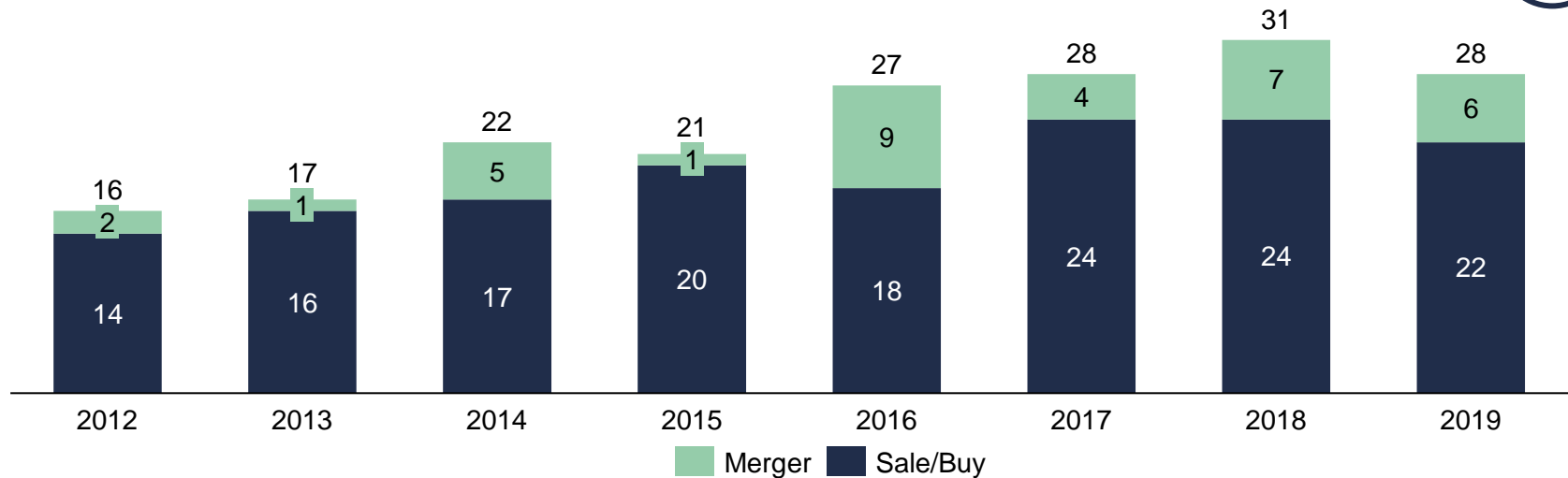
The outpatient market continues to be characterised by a high transaction volume, a certain lack of transparency and a high market attractiveness. The focus of transaction activities in recent years has been on some sub-sectors such as radiology and dentistry.

The impact of the COVID 19 pandemic cannot be fully assessed. However, a decrease in the number of patients specific to the various specialist groups is to be expected here as well.

Note: With the TSVG, the legislator has imposed restrictions, especially for the establishment of dialysis and dental MVZs (Medical Service Centres). Effects are rather marginal.

Since 2016, a comparatively high transaction volume can be observed with a peak in 2018

Number of transactions over time¹



Comment

- In 2019, **transaction volumes** declined slightly and were at the same level as in 2016.
- The year 2018 was marked by some **large transactions** such as the sale of **Paracelsus**, while in 2019 the focus was more on the sale of individual hospital sites.
- The decisive factor for transactions is the **attractiveness of the overall offer**, including the objective of the transaction; hospitals in a slightly worse economic position are also of interest if the hospital is only needed as a **vehicle for setting up an MVZ**.
- Private providers are backing off and no longer taking over every hospital offered on the market.

1) Minority interests were not taken into account.

From 2012 to 2019, homogeneous transactions dominate

		Ownership after the transaction			
		Non profit	Public	Private	Total
Ownership before the transaction	Non profit	56	12	20	89
	Public	3	18	11	33
	Private	0	2	63	64
	Non profit/ Public ¹	1	4	0	5
	Total	61	37	92	190

Comment

- The **greatest activity** in the area of consolidation is generated by hospitals that were in **non-profit ownership** prior to the transaction, particularly due to the transaction activity in North Rhine-Westphalia. The year 2018 is an exception: Here, consolidation activity was highest among private operators, although only slightly higher than among non-profit operators.
- The hospitals under **public ownership** have a comparatively low transaction volume. From various publications it can be seen that a medium number of public / municipal hospitals are at risk of insolvency.
- The number of **mergers of municipal basic and regular care providers**, as well as the number of key utilities, is expected to increase across all regions.

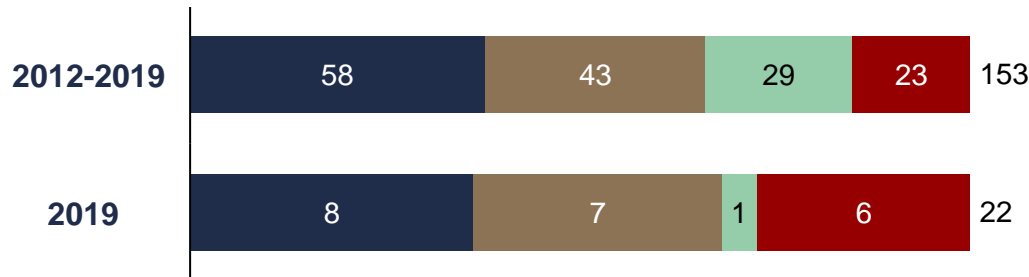
1) Mergers of different institutions; mergers of the same institutions are not listed separately; minority interests were not taken into account.

Hospitals with up to 200 beds were particularly affected by transactions in 2019

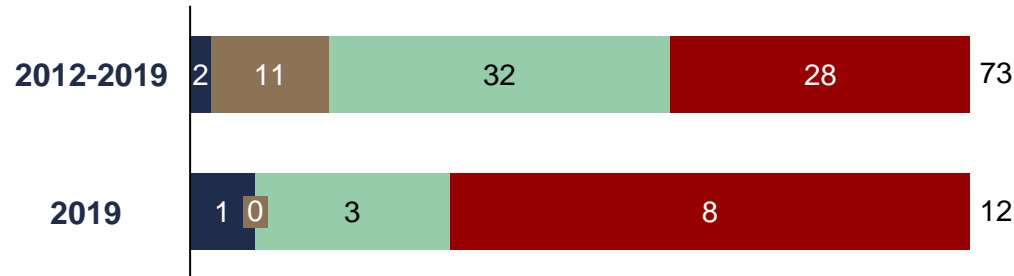


Transactions by bed cluster for the years 2012-2019¹⁾

Sale/ Buy by bed cluster



Merger by bed cluster



Key

01 – 99 beds
 100 – 199 beds
 200 – 499 beds
 500 and more

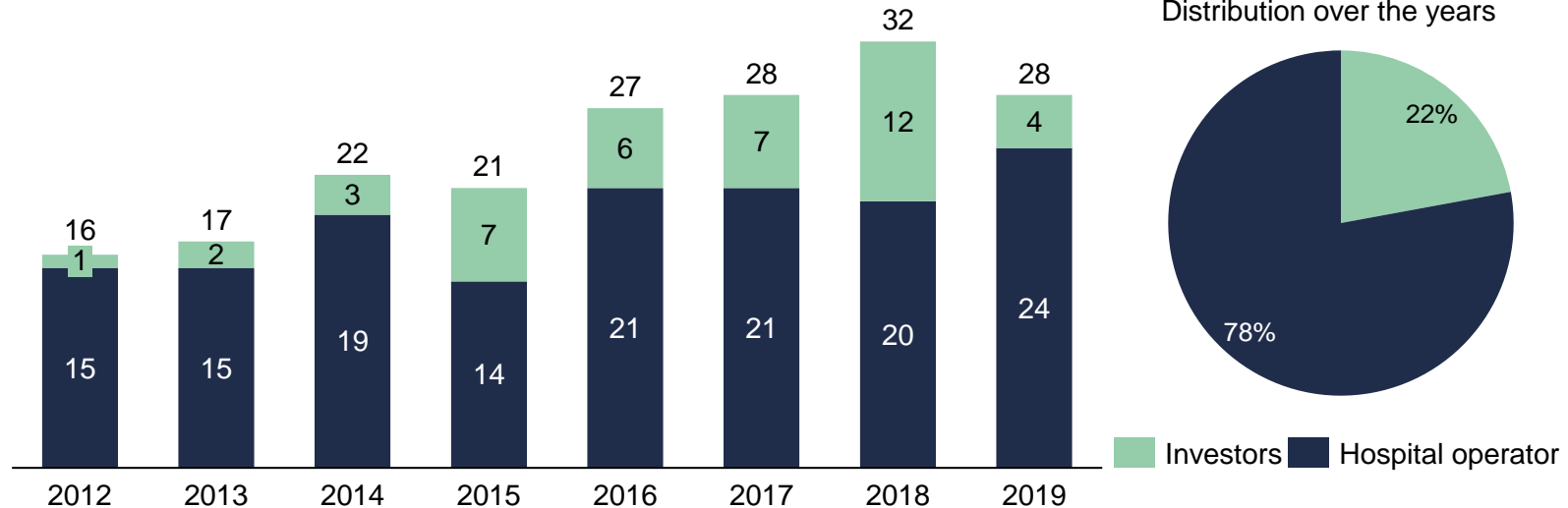
1) Minority interests were not taken into account.

2) Therefore, the total number of transactions (total) is not comparable with the total number on slide 12.

- When looking at sales over the years, the high number of transactions by hospitals with less than **100 beds** (n=58, 38%) is particularly striking. These are **primarily basic and regular care providers** as well as **specialist clinics**.
- In 2019 a comparatively high number of hospitals with **more than 500 beds** were sold.
- The mergers tend to take place in the area of large hospitals. In 2019, hospitals were equally divided between public and non-profit hospitals.
- In mergers, each transaction partner was included individually.²
- Two transactions are excluded from the calculation, as it was not possible to identify the beds clearly, but due to their structure they would have to be allocated to bed cluster 1 to 49 beds.

In 2019, the proportion of investors among buyers will have fallen sharply compared with previous years

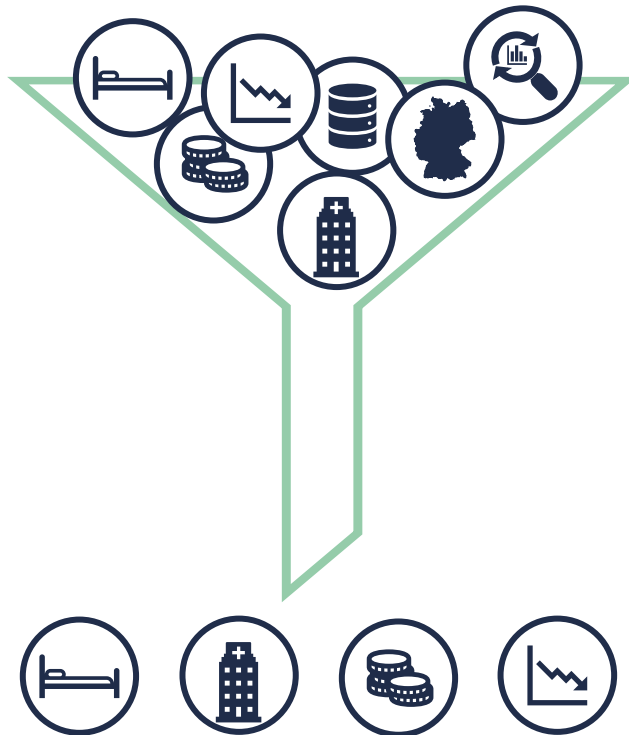
Transactions by parties involved



- The majority of the investors come from **Germany** or have had a connection to the German market for some time.
- Investors are more interested in **smaller facilities** (mainly under 100 beds) that are profitable or whose turnaround can be achieved quickly.
- The acquisition of a small licensed hospital (planned beds) serves investors as a means of entry to the MVZ market.
- The **consequences of the COVID 19 pandemic** could increase the number of targets for sale which are more interesting for investors than the current offer of clinics, some of which have been for sale for quite a while.

Sold hospitals can be characterised by some central features

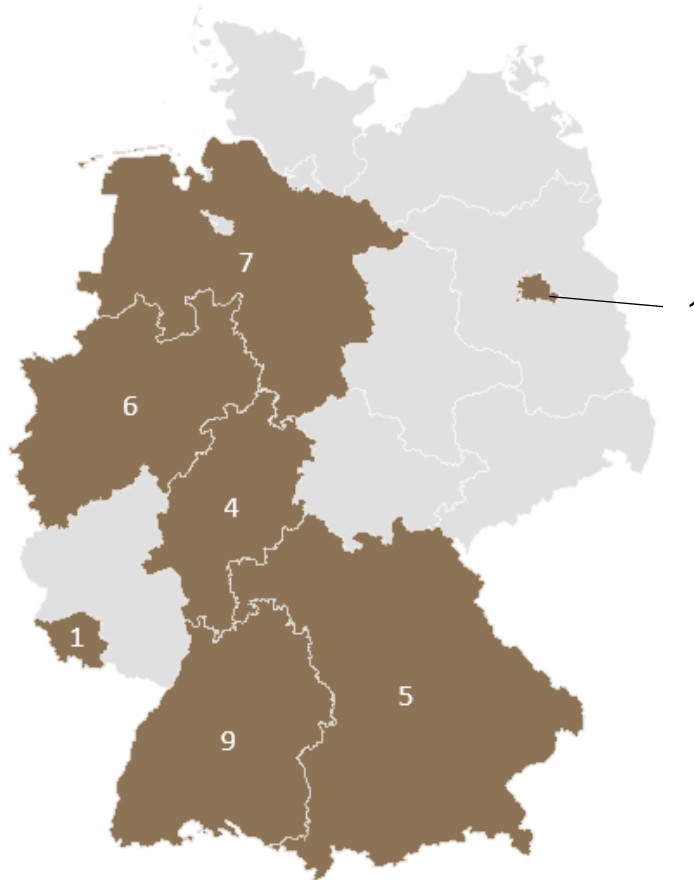
Methodology for market structuring



- Due to the large number of documented transactions in the inpatient sector, various similarities can be identified for sold hospitals.
- **Four central dimensions** can be identified which can be used to **characterise hospitals** sold in the **M&A context**:
 - ✓ **Amount of beds**
 - ✓ **Ownership**
 - ✓ **EBITDA-Margin**
 - ✓ **Debt ratio**
- Based on the M&A activities from 2010 to 2019, typical characteristics are identified and defined as **M&A indicators** for each of the dimensions.
- These are applied to the BinDoc database with structural and financial data on more than 700 hospitals to **screen potential candidates**.
- The hospitals identified from the screening process also correspond in essence to the characteristics of the hospitals acquired in 2019 and could therefore be targets in future M&A activities.

The distribution of hospitals corresponds to the transaction volume of the past years

Regional perspective



Note:
Number of identified hospitals per federal state

M&A indicators



Hospitals with a bed size between 100 - 199



In public or non-profit ownership



EBITDA-Margin < 2%

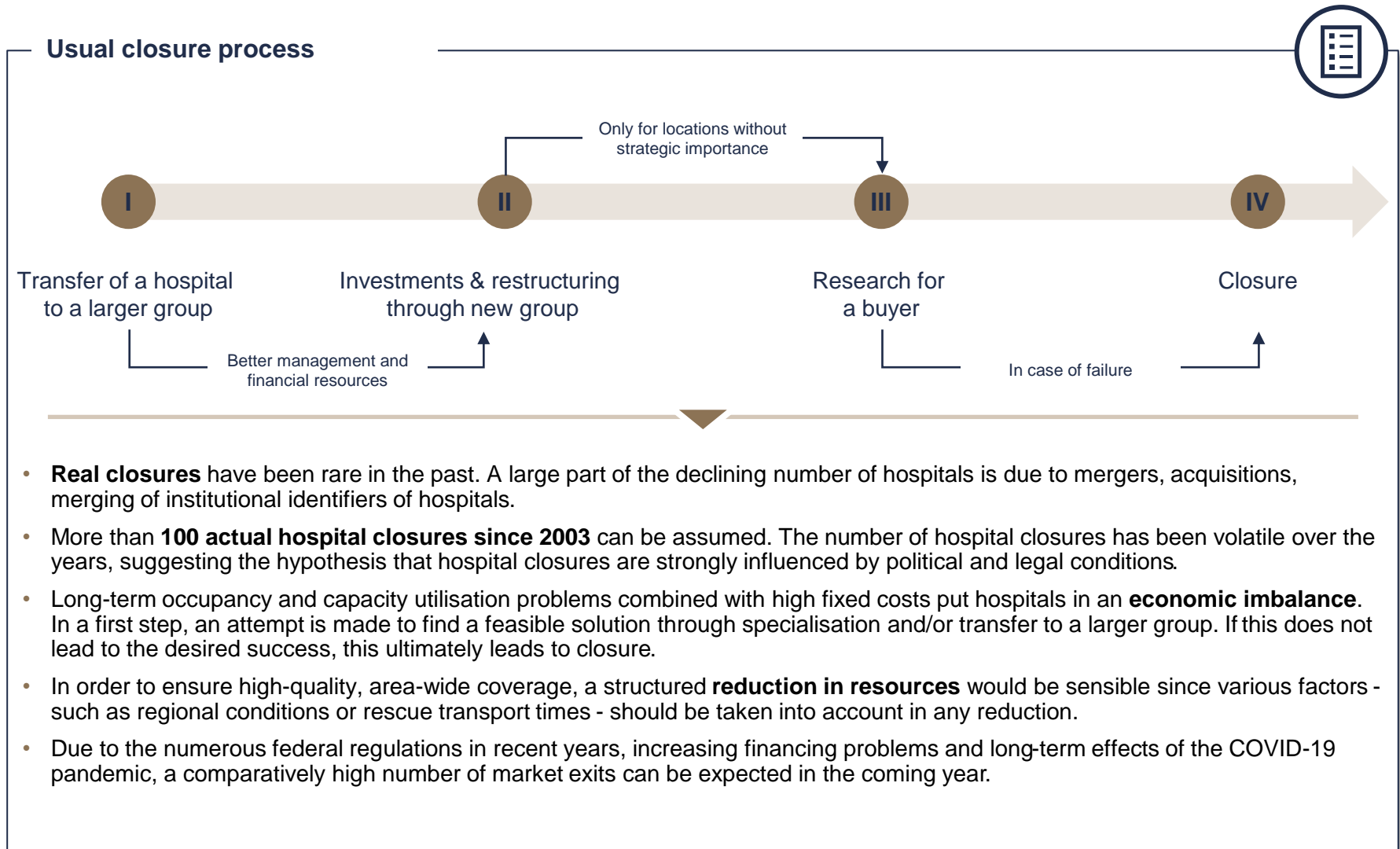


Debt ratio > 200%

Comment

- Of the more than 700 hospitals in the database, 33 meet all four of the M&A indicators with the limits defined above.
- The highest number is in Baden-Württemberg.

The concentration process in the hospital landscape increased again in the first quarter of 2020



For investors, our services as consultants focus on strategy development, implementation and integration

Strategy development



- Comprehensive market & competitor analysis + market trends
- Commercial Due Diligence
- Human Resources Due Diligence
- Approaches of Financial Due Diligence
- Research and inclusion of key opinion leaders from the network
- Analysis for service development/ improvement
- Business field analysis

Strategy implementation



- Comprehensive transaction support
- Plausibility check of business plans
- Company valuation
- Portfolio analysis / development / improvement
- Identification of targets
- Presentation of the company
- Action scenarios

Integration



- Post-merger integration
- Restructuring
- Reorganisation management
- Interims management
- Executive management

Example case

Examination of market entry into the MVZ market with acquisition of a hospital

Transaction: *Potential analysis for market entry, identification of hospitals targets, support in the acquisition of MVZ*

Parties involved: *International financial investor*

Oberender: *Market and potential analysis, identification of targets, commercial & operational due diligence*

The M&A competence team of Oberender AG



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... because M&A is teamwork




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