Crowe Horwath

The Global Corporate Advisor

September 2014

The Corporate Finance newsletter of Crowe Horwath International

Welcome to the September issue of The Global Corporate Advisor. From China, this newsletter has a special focus on the activities of China listed companies in the first half of this year. We find that despite the general economic downtrend, some factors continue to promote mergers and acquisitions. It is encouraging that local and central governments continue to push for steady growth and investments.

The global healthcare sector is also in the spotlight in this issue. Matthias Holtmeyer from Frankfurt examines if certain subsectors of the healthcare market are on a growth trajectory. Looking at the statistics, the answer is clear – M&A in the healthcare sector is growing.

From our Mexico office, Miguel Moreno Tripp and Alejandra Muñoz Soto examine the health sector in the country. Their snapshot of the healthcare systems introduces various government systems for medical insurance and treatment, along with listing notable transactions in 2013. Following reforms in various other sectors, the authors tell us, consolidation of the public health sector is next in the cards.

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Contact Us

The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact Peter Varley, Chairman of GCA, at peter.varley@crowecw.co.uk. Alternatively, please contact your local GCA team member to discuss your ideas.

Summary of Chinese Listed Companies' M&A Activities over First-Half 2014

Jason Zha and Dr. Jingxin Zhang, Beijing

M&A transactions volume and value

As of June 30, 2014, 863 deals were announced in the China M&A market (see Figure 1), which has fallen 24.83% compared to the same period in 2013. The cumulative worth of these deals is CNY344.565 billion, showing a 19.35% growth from the same period last year. The average transaction value is CNY399 million, which shows a significant increase of 58.77% over the same period in 2013.

In 2014, China's economic growth has remained on a downtrend. The downward pressure continues to increase, and there is no notable improvement in the market environment. Private capital investment is not active, which inhibits M&A activities and leads to a decrease in transaction volume from a year earlier.

However, some factors will continue to promote the M&A market. These include the central government's decision to deepen the reforms, the local governments' determination to realize "steady growth" via "steady investment," and private enterprises' need to expand and increase market share.

Figures 2 and 3 show the M&A transaction volume and value at China listed companies from 2005 to first-half 2014.

Figure 1. Comparison of M&A activities in H1 2013 and H1 2014

Period	Transaction volume	Total transaction value (in CNY hundred millions)	Average transaction value (in CNY hundred millions)
Jan - Jun 2013	1,148	2,886.91	2.51
Jan - Jun 2014	863	3,445.65	3.99

Figure 2. M&A transaction volume and value in China listed companies from 2005 to first-half 2014

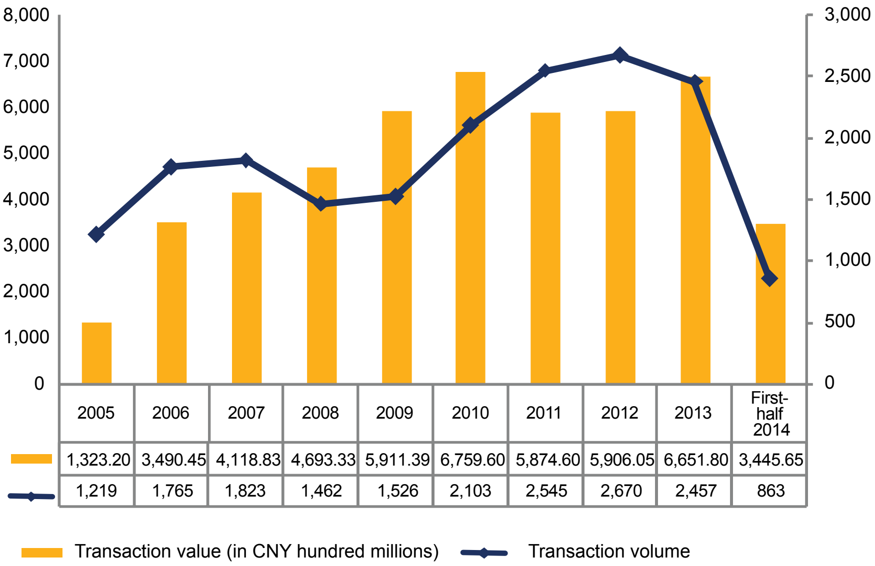
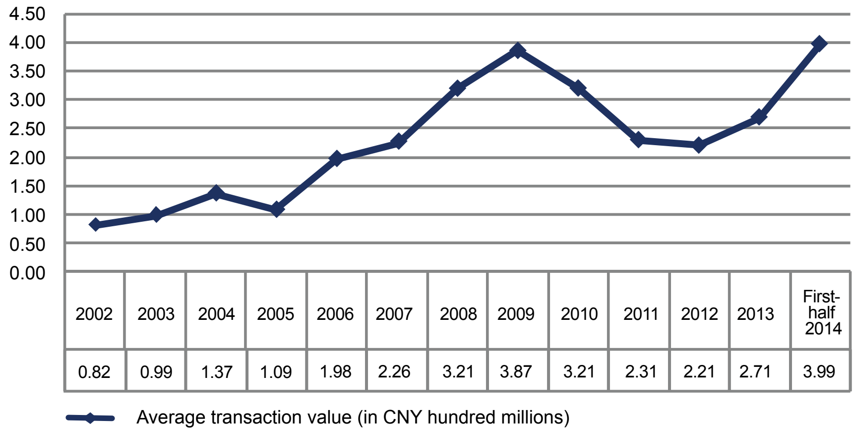


Figure 3. M&A average transaction value in China listed companies from 2005 to first-half 2014



M&A distribution by industry

Taking transaction volume as the sole parameter, the machinery and equipment industry ranks number 1 with 148 deals, which account for approximately 17% of the total volume. The information technology industry ranks number 2 with 110 deals, which is approximately 13% of the total. The real estate industry and social service industry follow on at number 3, each announced 76 deals. Figures 4 and 5 present the transaction volume and distribution by industry.

Figure 4. China listed companies' first-half 2014 M&A transaction distribution, by industry

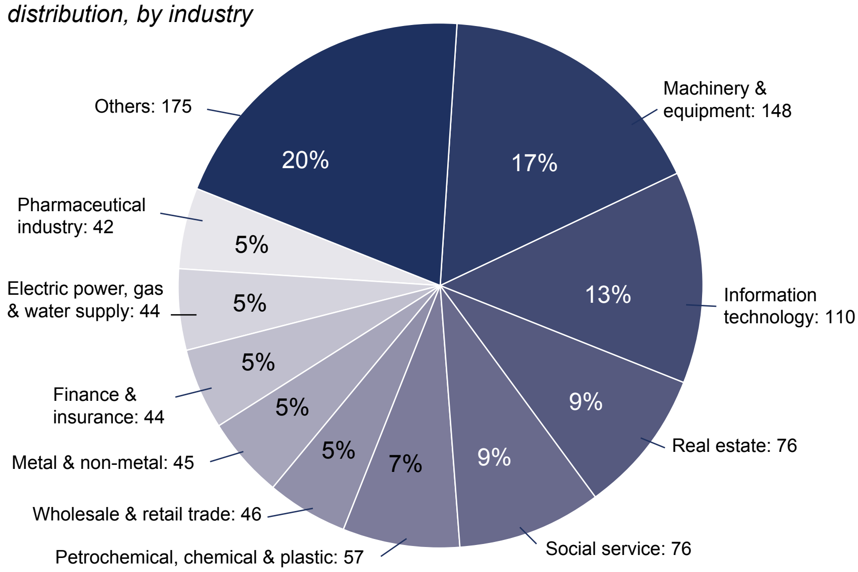
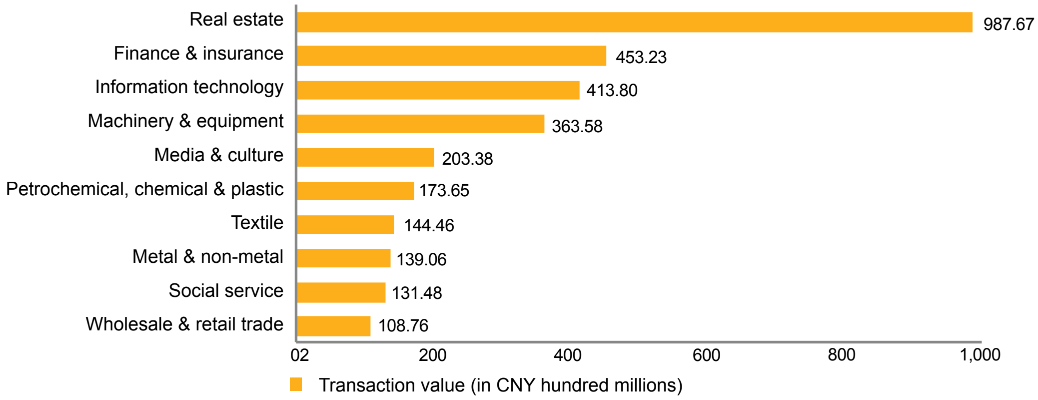


Figure 5. Top 10 industries with the most active M&A transactions in H1 2014

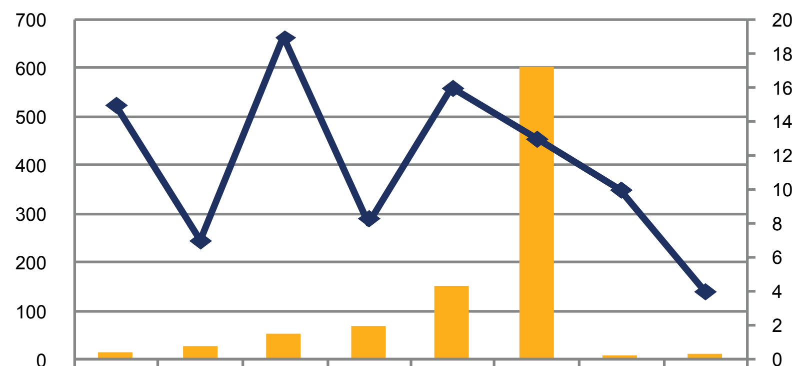


Cross-border M&A

The inbound M&A market remains depressed since 2014.

For first-half of 2014, the inbound M&A market in China showed no signs of improvement (see Figure 6) – only four deals have taken place, valued at a total of CNY1,193 million, with average transaction value of CNY298 million. Last year in 2013, 10 inbound M&A deals were announced, which accounted for CNY849 million in total and the average transaction value was CNY85 million.

Figure 6. China inbound M&A trends from 2007 to H1 2014



	2007	2008	2009	2010	2011	2012	2013	First-half 2014
Transaction value (in CNY hundred millions)	16.43	27.98	53.36	68.54	152.34	604.32	8.49	11.93
Transaction volume	15	7	19	8	16	13	10	4

Figure 7. Industrial distribution of China inbound M&A in first-half 2014 (by transaction value)

Industry	Transaction volume	Transaction value (in CNY hundred millions)
Social service	1	97,000.00
Finance and insurance	2	20,430.00
Electric power, gas, and water supply	1	1,883.79

All foreign investors for the four inbound deals in 2014 were from the United States, which might be the sign of economic recovery in that country. These deals involve three industries, as shown in Figure 7.

As the Chinese Premier Li Keqiang wrote in The Times, “We will delegate power and create more space to individuals and the private sector for economic activities, while enforcing government regulations with tighter oversight, and imposing tougher penalties on IPR infringement, environmental pollution and unfair competition. This will give foreign investors the same level playing field and greater space for development, just like their Chinese counterparts.” This will bring positive in luence on the inbound M&A market (see Figure 9).

The top targeted regions are Europe and United States; the most popular target industry in the past, mining, has been sluggish since 2014.

In H1 2014, the number of outbound M&A deals was 21, amounting to CNY14.886 billion, as shown in Figure 8. The average transaction value was CNY709 million, which was 1.78 times of the listed companies’ average M&A transaction value (CNY399 million), and was 71.22% higher than the 2013 average outbound M&A transaction value (CNY414 million).

Figure 8. China outbound M&A trends from 2007 to H1 2014

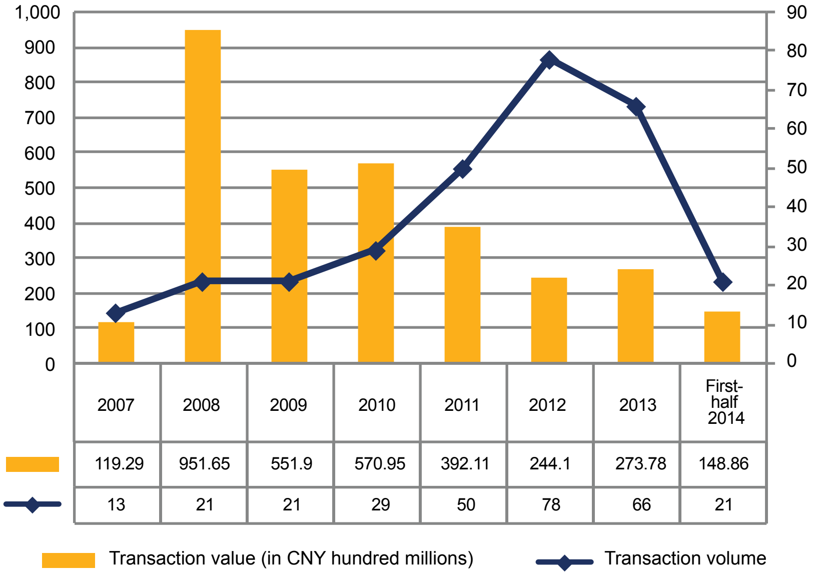


Figure 9. Industrial distribution of China outbound M&As in first-half 2014 (by transaction value)

Industry	Transaction volume	Transaction value (in hundred millions)	Average transaction value (in hundred millions)
Finance and insurance	4	80.26	20.06
Machinery and equipment	5	36.92	7.38
Wholesale and retail trade	3	17.33	5.78
Petrochemical, chemical and plastic	3	7.82	2.61
Information technology	4	4.97	1.24
Farming, forestry, animal husbandry and fisher	1	1.53	1.53
Mining and quarrying	1	0.02	0.02

From the above data, we can see that outbound M&A market in China will remain active. Because some foreign governments have concerns about the outbound M&A activities of China state-owned enterprises, the outbound M&A model still needs to be improved. For instance, the introducing different sources of capital, including state-owned enterprises, private enterprises and PE funds, giving full play to their respective advantages, has resulted in accelerating the development of outbound M&A market.

PE funds have been actively involved in the M&A market

According to the January-June 2014 China private equity market statistics, published by Zero2IPO Research Center, $7,802 million were raised for a total of 85 investable funds into China mainland market. Among those, mostly are Renminbi (RMB) funds. In H1 2014, 231 investments took place, resulting in $18.183 billion being invested. Popular targets, such as the internet industry became dominant investment targets again.

Due to a surge in the market in the previous year, investments in real estate declined significantly. Because of improvement in the China IPO market, 103 PE fund investments were exited in the first-half 2014, among those, more than 75% were through IPOs, followed by 17 M&A cases. M&A has become a major strategy for the exit of PE fund investments.

** Unless otherwise specified, all the data are from ChinaMerger - Chinese Merger & Acquisition Database, developed by Center for Chinese Merger & Acquisition Research, Beijing Jiaotong University.*

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Healthcare M&A: A Growing Market?

Matthias Holtmeyer, Frankfurt

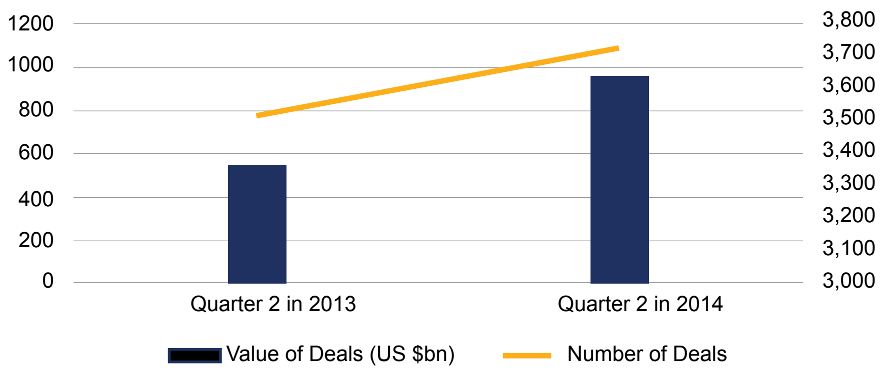
For decades the global M&A-market in healthcare was characterized by cross-border transactions in the pharmaceutical industry and start-up financing of young companies, the la - ter including several rounds of funding. Mergers in the hospital sector were primarily driven by privatizations and, within that, by domestic transactions.

The question we are asking is whether this is now going to change as in other industries, and, if yes, in which subsectors.

To answer this question it is important to analyze the motivation and regulatory burden of any subsector. Also, we need to see if there are any market indications of increase in M&A activity, maybe even in cross-border activity. Looking at the statistics the answer is clear: M&A in the healthcare sector is growing.

After a slight decrease in 2013,merg- ers and acquisitions have been picking up in 2014. Globally, the number of deals by volume in the first six months of 2014 increased by 6% and by 42% by volume compared to the first half of 2013. On the whole, the second quarter of 2014 saw 3,727 deals worth $957bn compared to 3,515 deals in Q2 2013 worth $555bn (see Figure 1).

Figure 1. M&A value and volume for Quarter 2 of 2013 and 2014



With several multi-billion dollar offers and deals announced in the first half of the year, 2014 is likely to become one of the busiest years for healthcare M&A. This applies especially to the pharmaceutical subsector, but also to med-tech and biotech deals. The driving factors in these subsectors are quite different.

Pharma/biotech

In pharmaceuticals, the search for new products – at its best the search for new blockbuster products – stands in the foreground, making the targets attractive. Comparatively speaking, the approach behind acquisitions of hos- pitals is that they benefit from a more professional management, abandoning ineiciencies and achieving a critical mass, or from becoming full-service clinics. On the other hand, med-tech is an extremely large sector covering a variety of applications and different types of customers. In this sector, we typically see two to three rounds of financing, followed by the med-tech entity's acquisition by a larger company.

In the case of med-tech, the acquirer's intention is usually to save the money on expensive research and development and instead look for innovative small caps having developed an interesting product, which has already passed all regulatory burdens. This allows the acquirer to then push sales and profits by selling the newly-owned product through established marketing and distribution channels, which a small company may not have at its disposal.

A recent example for this structure is a major deal in the biotech sector. Swiss Roche Holding AG has an- nounced that it would pay $8.3 billion for InterMune, a California biotech fir that researches and develops thera- pies for pulmonology and hepatology. InterMune reported total revenue of $66.0 million and a net loss of $124.8 million for the first six months of 2014 The planned acquisition underlines the fact that major pharmaceutical compa- nies are willing to pay big premiums in acquisitions that are likely to fill thei drug pipelines.

Healthcare services

In the services sector, major hospital deals have been completed this year. At the beginning of 2014 the takeover of HMA based in Tennessee, USA by Florida-based CHS was completed after several months of negotiations. Ramsay Health Care Ltd, Australia's largest private hospital operator, has bought a majority stake in the French private healthcare group, Generale de Sante SA in a deal valuing the European company at approximately $1.3 billion. In Germany, Fresenius completed its acquisition of 40 clinics from its competitor Rhön-Klinikum AG for a purchase price of €3 billion.

While big cross-border deals are very common for the pharma sector, so far the consolidation in the hospital market has been mainly limited to domestic acquisitions. Many strategic investors are rather reluctant to invest outside their home markets. The specifics of the national healthcare markets require tailored business models, which could not be easily transferred to other countries.

Therefore, the acquisition of a majority stake in Generale de Sante by Ramsay Health Care might be seen as an indication of increasing cross-border activity. The attractiveness of potential targets largely depends on the regulatory environment in which they operate. Due to budgetary constraints of the public sector, private operators and their financial resources are becoming more important for efficient provision of healthcare services. With increasing internationalization of investors for healthcare services, the systems themselves will be competing against each other. In the medium term, this will lead to international convergence.

Apart from hospitals, there are niche markets with significant consolidatio potential in the service sector. The clinical laboratory market, for instance, is one of the attractive sectors in the service industry, which has witnessed considerable growth. Players such as Quest, Sonic, LabCorp and LabCo have been successful in growing their business with several acquisitions.

The consolidation process generally happens in different phases. The initial concentration is often limited to companies within the specific sector if the targets are too small on a stand-alone basis for external investors. When groups have grown to a certain size they usually attract private equity (PE) investors, which help boost their growth by pursuing a buy and build strategy. As PE players normally have a limited investment horizon, the exit to a strategic investor is a favorable option.

Labco, which is a pan-European clinical diagnostic services provider, grew its turnover from around €50m in 2003 to over €575m in 2013. 3i has invested €130m since July 2008 and Labco has made more than 90 acquisitions of small and medium-sized labs during this period. Last year, Labco sold its German activities to Sonic Healthcare Ltd, which is one of the largest diagnostic companies globally.

Similar to the clinical lab market, other segments still have enormous consolidation potential. For instance, the radiology market is still very fragmented in many countries. This offers not only attractive investment opportunities for financial investors but also for strategi players that already have a significan size investment in their home market and are interested in cross-border acquisitions.

Med-tech

In the med-tech sector the merger of US-based Medtronic with its competitor Covidien ($43 billion) was one of the biggest transactions in 2014. Moreover, Zimmer Holdings Inc in April 2014 agreed to acquire Biomet Inc, a producer of medical devices such as artificial hip joints and dental implants, for approximately $13.35 billion. In August this year, the German engineering group Siemens announced the sale of its hospital IT business to Cerner Corp, a US provider of healthcare IT services, for $1.3 billion in cash. In the same month, Siemens Healthcare sold its microbiology business to Beckman Coulter Inc., a wholly owned subsidiary of Danaher Corporation. The activities of the microbiology business include systems for the identification and antibiotic susceptibility testing of microorganisms.

As described, the healthcare sector encompasses a wide range of activities with specific business models. Crowe Horwath therefore has a Healthcare Special Interest Group (SIG), which is headed by Shane McQuillan, Partner at Crowe Horwath in Ireland. Based on the increasing importance of cross-border M&A in the healthcare sector, the SIG is also focusing on M&A-advice for Crowe Horwath clients around the globe.

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Mexico's Health Sector

By Miguel Moreno Tripp and Alejandra Muñoz Soto, Monterrey

This article presents an overview of the health sector in Mexico, starting with a description of the government institutions, which account for roughly 50% of the services provided, followed by publicly available data on M&A. It ends with select data on Medica Sur, a Mexican listed healthcare company.

For a long time, two parallel health systems have been in place in Mexico – the Ministry of Health and the Instituto Mexicano del Seguro Social (IMSS, established in 1943). Between 1950 and 1960, oil company Pemex, Semar (the navy) and Sedena (national defense) established their own health systems and in the early 1960s the ISSSTE (The Institute for Social Security and Services for State Workers) was founded.

In 2003, health reforms were implemented. The main component was the national health insurance program, Seguro Popular, oriented towards poor families. Its fee is capped at 5% of their disposable income (equivalent to less than $1,000) and poorer states receive more financial resource than the richer ones. Also, a national reserve has been implemented for catastrophic illnesses. Until 2012, 52.9 million people have been affiliated

According to a study, "IMSS covered health care of private sector workers and their families (40% of the population), and additional insurance programs covered another 10%, but this left approximately half of all Mexicans without prepaid insurance". This study also says, "A key foundational idea of the health reform in Mexico was to move from the national health service system… to a national insurance model, in which a national health insurance plan would cover a certain defined set o health needs and services, and program participants could be treated by any provider accepting government payment, including private providers. The focus for the government, then, is on the finan -ing of the system rather than a public network of service provision".[1] Figure 1 summarizes the health sector in Mexico.

Figure 1.

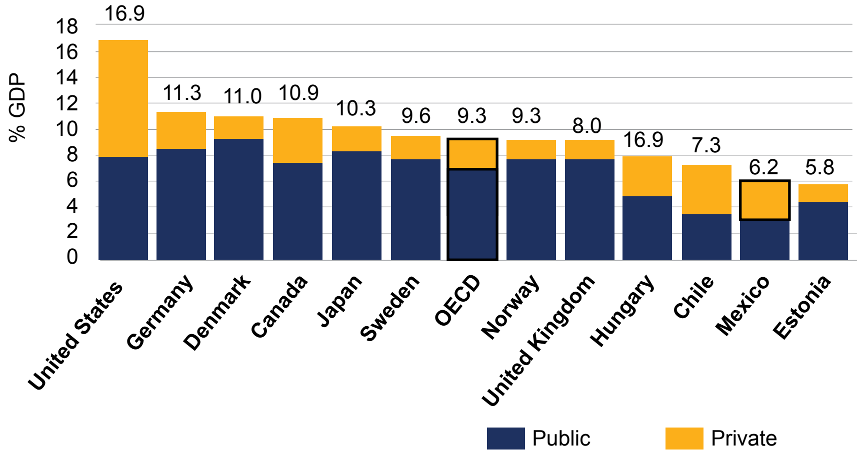
Service provider	Population Served	Financing
Institutions that provide service to an open/uninsured population		
Ministry of Health	Self-employed, unemployed, and employees in the informal economy	Federal government and user fees
State Health Services		Federal government, state governments and user fees
IMSS - Oportunidades	Vulnerable and marginalised population	Federal government
Institutions that provide services to a population with social security		
IMSS	Employees of the private sector of the formal economy and IMSS employees	Federal government employers and employees fees
ISSSTE, SEDENA, SEMAR, PEMEX	Employees of the public sector of the formal economy	Federal government and employees
Institutions of the private sector		
Private hospitals and clinics	Individuals with or without social insurance and with larger ability to pay for health services	Employers and employees

Note:1 ISSTE State Workers Institute of Social Security and Services *(Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado)*, SEDENA: Ministry of National Defense *(Secretaría de la Defensa Nacional)*, SEMAR: Ministry of the Navy *(Secretaría de la Marina)*, PEMEX Mexican Petroleum *(Petróleos Mexicanos)*

[1] *Diane Marie Kuhn. Health Care Reform in Mexico and Brazil: The politics of institutions, spending and performance. 2012*

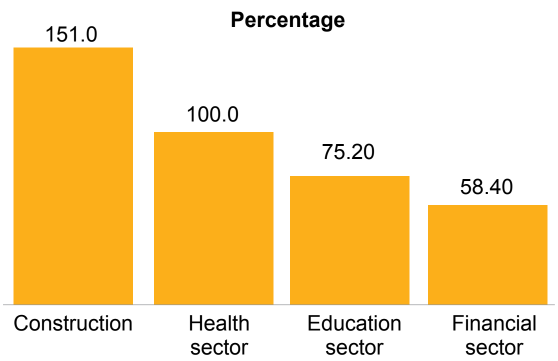
Figure 2 shows the percentage of Mexico's GDP ($2 trillion; per capita: $18,288; Population 110 million) invested in health, compared to a sample of other OECD countries as well as the composition of public/private spending. This compares with a 70% average of OECD's countries public expenditure. It amounts to $62.3 billion in 2012.

Figure 2. Health expenditure, public and private as a share of GDP, OECD countries, 2012 or latest year



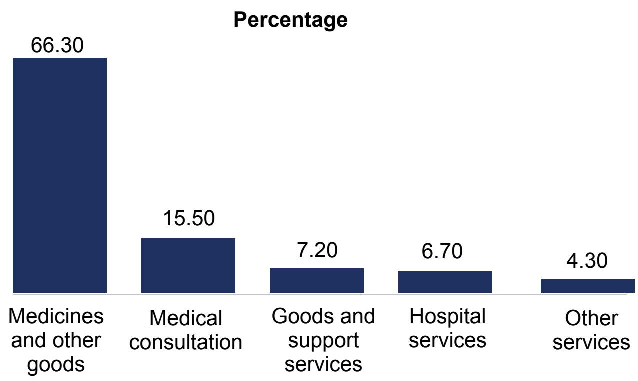
Source: OECD Health Statistics

Figure 3. GDP in the health sector to GDP by economic activity selected, 2012



Source: INEGI Health sector's satellite account. Mexico 2012

Figure 4. Distribution of household spending on goods and health services, 2012



Source: INEGI Health sector's satellite account. Mexico 2012

According to the OECD, the per capita expenditure on health is $1,048, comprising less than 6% of per capita GDP. If we compare total health expenditure vis-à-vis other economic sectors in Mexico, we would have the information depicted in Figure 3. Figure 4 disaggregates such expenditure by different types. The health sector employs around 1.78 million people, equivalent to 4.2% of Mexico's total employment. Still, Mexico is below the OECD average, as shown in Figure 5.

Figure 5.

Mexico's key facts; OECD Health Statistics 2014	Mexico		OECD Average	
Health Status	2000	2012	2000	2012
Life expectancy at birth (years)	73.3	74.4	77.1	80.2
Risk factors to health (behavioral)				
Obesity rates among adults (%)	24.2	32.4	18.7	22.7
Health care resources				
Number of doctors (per 1,000 population)	1.6	2.2	2.7	3.2
Number of nurses (per 1,000 population)	2.2	2.6	7.5	8.8
Hospital beds (per 1,000 population)	1.8	1.6	5.6	4.8

In 2013, according to Bloomberg, the most notable transactions were:

- Naviscan's assets were sold to Compañía Mexicana de Radiología SA de CV for an undisclosed amount. Naviscan is a San Diego-based maker of high-resolution medical imagers, specialized in positron emission imaging, an alternative to X-ray imaging. CMR, a Mexico-based company, has been a developer and manufacturer of quality diagnostic imaging equipment and healthcare IT solutions for more than 25 years, and plans to continue sales and support of Naviscan's technology.

- The Adval Tech Group Holding AG (Swiss) sold its medical technology activities in Mexico to an US-based company called Philips Medisize Corporation, a global outsource provider of design and manufacturing services to the medical device and diagnostics, drug delivery and commercial markets. The amount of this transaction was undisclosed. However, we do know that the seller's price to book ratio (P/BV) was 2.20 and its price to sales ratio (P/S) was 0.52 at that time.

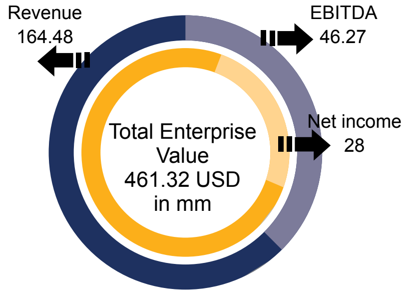
- Aspen Pharmacare Holdings Ltd acquired Nestlé's infant nutrition business in the acquisition of license rights to intellectual property, net assets (including a child nutrition production facility located in Vallejo, Mexico) and shares in the child nutrition businesses so far conducted by Nestlé and Pfize in Latin America. The transaction amount was $215 million. The seller had a P/BV of 3.85 and a P/S of 2.47.

Mexico has just passed a comprehensive reform package for its energy, education, financial, tele ommunications and electoral sectors. There are rumors that the next major reform will be consolidation of the public health sector, which may lead to the merging of IMSS, ISSSTE and perhaps some of the Ministry of Health services.

Medica Sur SAB de CV
(Mexico: MEDICAB, Currency: USD)

Medica Sur S.A. operates medical facilities. The company's specialty hospitals and medical clinics offer diagnosis, consultation and treatment services. The facilities are also used for research and acedemic purposes.

Financial information 12/31/2013 LTM



Multiples	
P/BV	1.7x
P/CF	10.1x
P/E	12.4x

Ratios	
ROA	11%
ROE	138%
LT D/E	0%
FCF margin	10.9%
EBITDA margin	28.1%

Source: Bloomberg FX13.1059 MXN/USD

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