



# Eurovision

Investors from across the continent are being drawn to the robust German healthcare market. **Adrian Murdoch** looks at deal activity in Europe's strongest economy

Consolidation is the name of the game at every level in the German medical sector. At the moment, all industry watchers have an eye on Bad Homburg-based healthcare group Fresenius. At the end of April it made clear its intentions to become the country's largest private hospital operator through a €3.1 billion (£2.5 billion) takeover offer for arch rival Rhön-Klinikum.

"The proposed Fresenius-Rhön transaction is just the start of more consolidation in Germany and Europe," says Martin Henrichs, managing director of the healthcare team at Credit Suisse. "It is a huge step for the hospital industry."

It will be a game changer in a country where around 30% of German hospitals are privately owned. Local councils look after 32% and 38% are held by religious institutions. Should the deal get the nod from the country's competition

commission – and no one is seriously suggesting that it won't – the proposed €3.1 billion offer for Rhön's 53 hospitals and 39 healthcare centres would double the revenues of Fresenius's existing hospital subsidiary, Fresenius Helios, whose 63 nationwide hospitals reported revenues of €2.7 billion last year.

The deal financing is complicated. Fresenius decided to bid €22.50 a share for Rhön. That is a hefty 52% premium on where the shares were trading before the

takeover was announced, but premium pricing was needed to reach the 90% acceptance for the bid. A mix of loans, bonds and equity are envisaged to fund the deal, with commitments already in place for €5.3 billion.

The levels of commitments should not be a surprise. Fresenius has long been one of the darlings of the debt market. Although technically a high yield company – it is rated Ba1 by Moody's and BB+ by Standard & Poor's – it tends to borrow at investment grade levels.

Fresenius might be getting the media attention, but the company's action is being reflected throughout the German healthcare market. Acquisitions of European, private equity-owned medical facilities have rocketed since 2009. Then they stood at €1.5 billion. By 2011 they stood at €6.3 billion according to Credit Suisse. No slow down is expected any time soon. More than 20 such assets are expected to come to market this year.

For British companies with their eyes on European expansion, Germany is a natural home. While much of the rest of Europe is suffering tightening purse strings, the German statutory healthcare insurance funds have piled up reserves – almost €20 billion in 2011. The figures speak for themselves. In 2010 Germany spent 11.4% of GDP on healthcare, as opposed to 9.2% in the UK, according to figures from Credit Suisse. "Historically the UK has always spent less on healthcare than Germany or France," explains Henrichs. Due to a current scarcity of staff, Germany's healthcare system is likely to add a further 70,000 jobs this year to its more than four million employees according to the German Association of Chambers of Commerce & Industry in a report in April.

The past 18 months have seen a flurry of British acquisitions in the German market. In February last year private eye care group Optegra acquired Berlin-based chain Augentis, with the help of

investment firm Moonray Healthcare. Tim Clover, chief executive of Moonray, said the deal would serve as a "platform to accelerate growth in Germany". In October, Priory Group owner Advent International, together with venture capital firm Marcol, acquired German private clinic and care home operator ORK. In December last year, Cheshire-based Advanced Medical Solutions bought Nuremberg-based woundcare specialist Resorba for €63.8 million in cash funded via AIM and a €25 million loan.

The experiences of Alva-based medical testing company Omega Diagnostics are typical. Omega, which specialises in food intolerance testing and tests for infectious and auto-immune diseases, saw a 41% increase in profits to £11 million this year, thanks primarily to its acquisition of the German lab-testing company Allergopharma in November 2010.

In 2010 Omega was introduced to an IVD (in vitro diagnostics) unit in ►

► Hamburg – the €4 million testing arm of Allergopharma. Kieron Harbinson, group finance director of Omega Diagnostics, explains that the acquisition process took from April 2010 to December of the same year. The acquisition itself was a reverse transaction through AIM. Omega raised £7.75 million: £5 million was for the acquisition itself, £1 million for fees and the rest for the war chest.

“Germany had not been a large market for the company – it was not even in the top 20, now it is the largest market,” says Harbinson. He points out that of the German subsidiary’s turnover, well over 90% of it is domestic. A significant point given that Germany is Europe’s single largest IVD market.

Cardiff-based EKF Diagnostics goes even further. Again in 2010 the company was introduced to a German manufacturer of point-of-care blood analysers used in the measurement of glucose, lactate, haemoglobin and haematocrit. Based in the former East German city of Magdeburg it had more than 100 employees in R&D, manufacturing and distribution. Tony Wilks, the company’s sales and marketing director, explains how the acquisition gave them access not just to Germany, but to the eastern European market. “From Magdeburg, you can be in Poland in two hours,” he says. EKF saw turnover rise 234% last year to £21.7 million.

The geographical access appears to be a clear driver. When Richard Steeves’ LSE-listed Synergy Health spent €9.5 million on Dresden-based Gamma-Service-Produktbestrahlung, which provides gamma and ebeam sterilisation services to the healthcare and industrial sectors, the chief executive was blunt. “This acquisition... opens up further opportunities in eastern Europe,” he said in December 2010.

All good news, but this is not to say that Germany has escaped belt-tightening. The last few German governments have been turning the screw on health insurers (themselves under pressure of consolidation – the number of public health insurance providers has declined to below 202 from 455 a decade ago) by pressuring them to cut administrative costs. What has emerged are tough new pricing policies for hospital treatment, greater competition among GPs by allowing them to club together and form Medizinisches Versorgungszentrum or

health centres, and a cap on prices for the most expensive drugs.

A refrain that is sung by every medical company is that as long as their treatment is reimbursed by the health insurers, then they are fine. As EKF Diagnostics’ Wilks points out: “Laboratory pathology makes up only 2-3% of [hospital] spend, but it is an easy target if there is cost cutting.”

At the moment German Chancellor Angela Merkel is too distracted elsewhere. Aside from the eurozone crisis, her Christian Democratic Union party has performed poorly in a series of regional elections this year. Mostly recently, in mid May, she was punished in North Rhine Westphalia, Germany’s most populous state. Given that the vote is generally seen a dress rehearsal for the national elections, which will be held in September or October next year, Merkel is unlikely to address the health sector head on, especially in any ways that would be unpalatable to voters. “Nothing big will happen before the election,” agrees Tobias Brodtkorb, consultant at Sempora Management Consultants.

Nonetheless, consolidation in the sector is going to continue and will impact all medical stakeholders. This is precisely why the players in the German healthcare market are looking at the Fresenius deal so closely. It is a truism in Germany that any hospital above 800 beds looks at quality, anything below that looks at price, but that only goes so far. “Size is important. For example you get better deals with pharmaceutical companies if you have scale,” says Brodtkorb. As a result, price pressure remains a sword of Damocles over any medical company.

Although some see the increased power of the buying cooperatives and health centres as a challenge, Omega Diagnostics’ Harbinson sees it as an opportunity. Smaller individual doctor surgeries are unlikely to buy a closed system analyser to test 600 allergens, for example, but medical centres might. Rather than complain about the new world order, better to embrace it.

Although it is still early days, what is beginning to emerge is a medical landscape that EKF Diagnostics’ Wilks vividly describes as looking like a dumbbell. “We used to see sausage segmentation in the market, now it is a dumbbell. The middle is squeezed, but there is money at both ends.” ■

### German healthcare in numbers

**11.6%** Percentage of GDP spent on healthcare in 2009

**\$4,218** Healthcare spending per capita in 2009

**5.0%** Average annual growth rate of real healthcare spending per capita, 1999-2009

**5.7** Number of acute care hospital beds per 1,000 population

**7.5** Average length of stay for acute care (days)

**14.7%** Obesity (BMI>30) prevalence

Source: The Commonwealth Fund, November 2011 report