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China healthcare: taking the private route

Issue V, December 2014

China's vast demographics, ageing population and ongoing reforms in the healthcare industry have sparked global interest as investors compete for a slice of the nation's healthcare pie, estimated to be worth USD1 trillion by 2020.[1] Now, previously introduced rules for this formerly tough-to-penetrate sector are spurring deals as investors seek to capitalize via carve out, Greenfield investment, JV or buy-out.

Rapidly rising income levels in China along with the population's higher expectations are prompting inevitable change: healthcare M&A deals in China were valued at CNY3.1 billion for the 9 months to September 2014 – about triple the value from full year 2013.[2]

Since Beijing began introducing the new healthcare reforms in 2009 and lifted restrictions for foreign investment in China's private hospitals in 2012, market interest in China healthcare-related public share issuance has surged: CNY3.2 billion was raised between May 2013 and August 2014; a stark contrast to the approximate CNY0.4 billion raised in 2012.[3] Also, some CNY1.7 billion was invested in 2013 in taking public hospitals private[4] as investors strive for new business models and new sources of income (often supply-chain oriented).

Indicative of such trends are several key deals: Fosun Pharmaceutical's CNY2.8 billion acquisition of Chindex in April 2014[5]; Phoenix Healthcare Group's HKD1.48 billion fund-raising on the Hong Kong Stock Exchange late 2013[6]; and the recent signing of a provisional agreement to operate four or five hospitals in Chengdu by Australian firm Ramsay Health Care via its JV arm with Malaysian group Sime Darby.[7] Others include Greenfield hospital investments by Chinaco Healthcare Group and Trustbridge Partners[8], and Hony Capital acquiring one of Shanghai's largest private hospitals in October this year.[9]

Though nearly half of China's approximately 24,700 hospitals are private (though typically far smaller in scale compared to their public counterparts), public facilities account for about 84% of medical services provision.[8] The government seeks to have private hospital beds and patient visits at 20% as a proportion of the nation's total by end 2015[10]. Notably, Shanghai's equivalent non-public proportion is currently 8%, though this may rise given the city's trial free-trade zone – which allows wholly foreign-owned hospitals – and which might prove a test bed for similar schemes elsewhere.[11]

Currently, average number of beds per 1,000 registered population in China is 4.55, with beds at private hospitals accounting for just 0.52 of that figure[11], and consultation times at public facilities can be as little as 2-3 minutes[8] – exemplifying the limited customer care. We expect China's rising middle class to demand greater choice and quality of healthcare; constraints include the need to reform the social security and commercial insurance regimes, and the relatively scarce availability of qualified healthcare specialists and associated need for investment in training.

This – in line with the government's broader strategy of re-dressing the healthcare sector by increasing supply, encouraging competition, clamping down on corruption, and addressing skills shortages – will likely mean more M&A and market consolidation ahead.

Market entry to opportunities in this sector in China could be via Greenfield investment, carve-out of publicly owned hospital operations or acquisition.

Depending on the option taken the following key considerations should be considered:

- Acquisition or carve-out/operational line separation of clinics may prompt protracted negotiations given political sensitivities and potential for industrial action, necessitating assistance in dealing with authorities.
- Challenges of Greenfield investments include timeframe (lead times of about 6-8 years), financing (capital verification and funding requirements), talent recruitment and real estate (land use rights, property certificates etc.)
- Privatizing public facilities (formerly untaxed) would trigger diligence given post-deal tax imposition under private status. Also, asset ownership legalities, unity with national health insurance scheme and potential statutory valuations would need circumspection.

1. China urges more private capital in health insurance sector (Aug. 2014), *Reuters; 2. Bloomberg.com*; *China Economic Net*; 3. *Bloomberg.com*, *HealthIntelAsia.com*; 4. *Bloomberg.com*; *HealthIntelAsia.com;* 5. Fosun-TGP Group Agrees to Buy Chindex with Sweetened Deal (Apr. 2014), *Bloomberg*; 6. Asia Private Equity Weekly News (Dec. 2013), *Reuters*; 7. Ramsay Health Care signs China deal (Nov. 2014), *The Sydney Morning Herald;* 8. Dearth of doctors drags on China private healthcare drive, (Oct. 2014), *Reuters*; 9. Hony Capital Acquires one of the Biggest Private Hospitals in Shanghai (Oct. 2014) *China Bionews* 10. China encourages private investment in hospitals, (Sep. 2012), *Xinhua*; 11. Private Sector Health Development in Shanghai (Dec. 2014), *Shanghai Health Development & Research Center*; Credit: KPMG China's James Harte (Manager) and Nick Lindsey (Editor) contributed to this article.

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