Corporate Finance
Healthcare Sector

M&AInsights

Analysis & opinions on UK M&A activity

2006/2007

PricewaterhouseCoopers

Welcome

Welcome to this edition of Healthcare Insights, a review of M&A activity and key trends within the UK healthcare market, by PricewaterhouseCoopers Corporate Finance.

This report highlights some of the deals and developments that occurred in 2006 and the first half of 2007, another period of increased M&A activity.

Private equity players have been a key driver of M&A activity as they continue to consolidate different market segments - the elderly care and hospital sectors have been particularly buoyant over the last 18 months.

We anticipate continued M&A activity within the broad healthcare sector, driven by private equity and trade players still eager to invest in a sector with strong fundamentals.

If you would like to discuss M&A trends or any other issues facing the healthcare industry, please do not hesitate to contact me or a member of our dedicated sector team.

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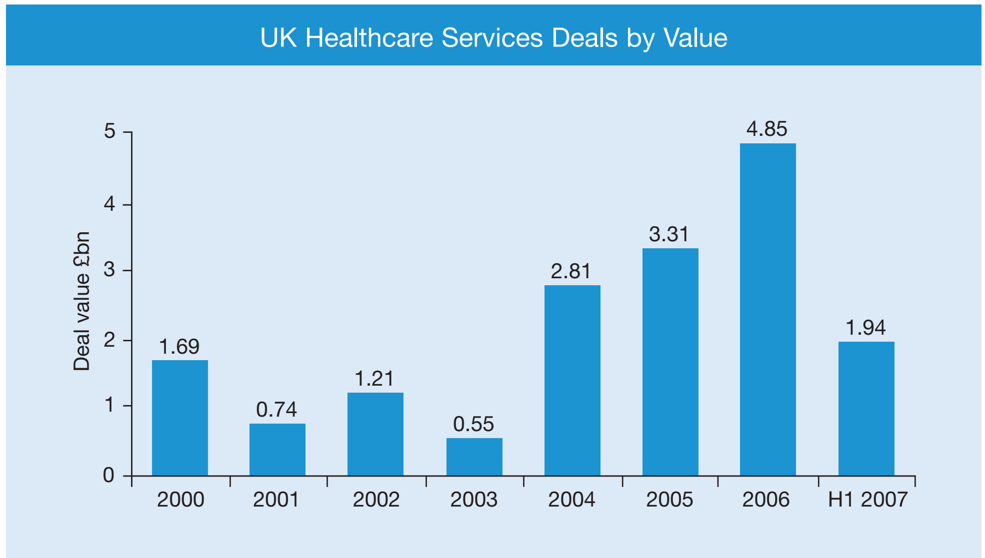
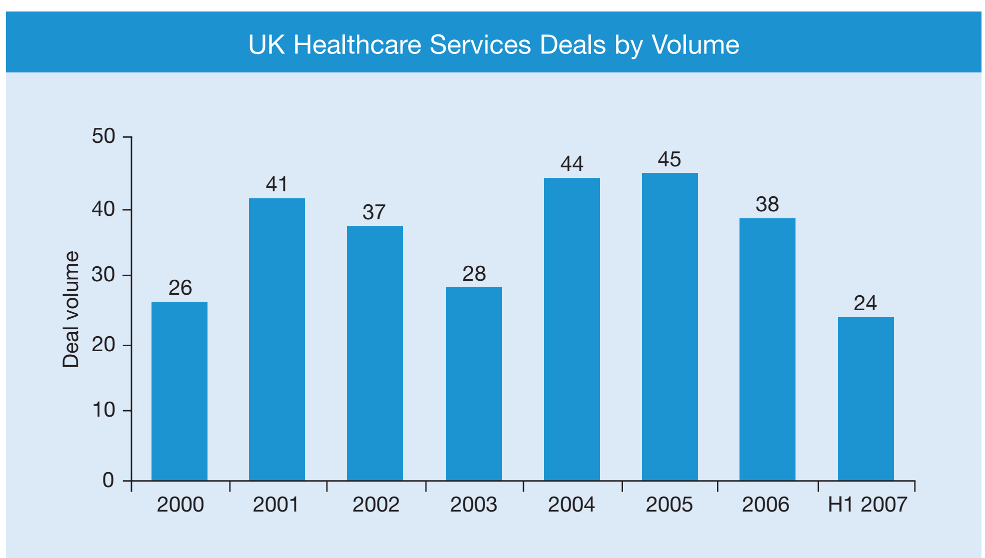
A robust market

The UK healthcare market remains buoyant into the first half of 2007.

During the first half of 2007 there have been 24 transactions at a total value of £1.94bn. This compares to 38 transactions at a combined deal value of £4.85bn during the whole of 2006.



Source: Dealogic, Mergermarket, Reuters, PwC analysis



Source: Dealogic, Mergermarket, Reuters, PwC analysis

Large private equity backed deals

Large private equity backed deals have dominated both 2006 and the first half of 2007.

In 2006 the acquisition of General Healthcare Group by Netcare UK and Apax, and the acquisition of Four Seasons Health Care by Three Delta had a combined deal value of £3.6bn. So far in 2007 the biggest deal in the sector is Cinven's £1.4bn acquisition of BUPA's Hospital business.

Healthcare Top Five Deals January – June 2007

Rank	Deal Value (£m)	Target	Sector	Acquirer
1	1,440	BUPA Hospitals	Hospitals	Cinven Ltd
2	120	The Regard Partnership Ltd	Specialist Care	Mezzanine Management
3	97	Avery Healthcare (home assets)	Elderly Care	Southern Cross Healthcare Group plc
4	77	Mercury Health Holdings Ltd	Hospitals	Care UK plc
5	66	InHealth Group Ltd (Sterile medical consumables and decontamination business)	Medical Supplies	Davis Service Group plc

Source: Dealogic, Mergermarket, Reuters, PwC analysis

Healthcare Top Ten Deals 2006

Rank	Deal Value (£m)	Target	Sector	Acquirer
1	2,200	General Healthcare Group Ltd	Hospitals	Netcare UK and Apax
2	1,400	Four Seasons Health Care Ltd	Elderly Care	Three Delta LLP
3	322	Paragon Healthcare Group Ltd	Specialist Care	Hg Capital
4	255	Castlebeck Care Holdings Ltd	Specialist Care	Lydian Capital
5	100	Helen McArdle Care Ltd	Elderly Care	The Bondcare Group
6	88	James Hull Associates	Dental	Hutton Collins & Company
7	88	Clinovia Ltd	Domiciliary Care	BUPA
8	80	The Robinia Care Group Ltd	Specialist Care	Barclays Private Equity
9	80	Integrated Dental Holdings	Dental	Legal & General Ventures
10	70	Independent Living Organisation	Specialist Care	Hermes Private Equity

Source: Dealogic, Mergermarket, Reuters, PwC analysis

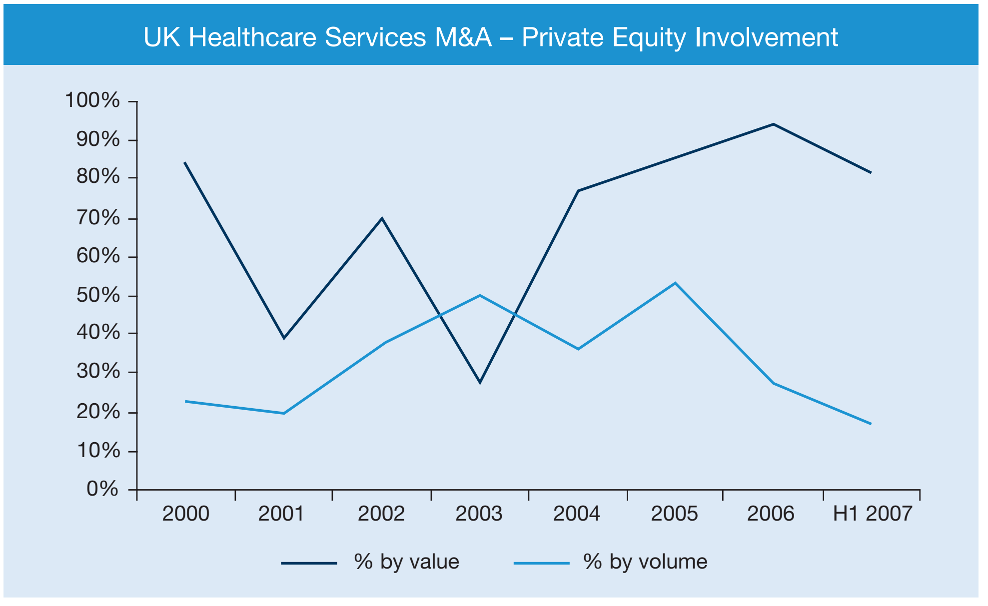
Private Equity

Private equity continues to be attracted to the healthcare sector.

In 2006 eight out of the top ten healthcare deals had private equity acquirers, and in the first half of 2007 this trend has continued with the top two deals attracting private equity investors.

Notably this interest in the healthcare services sector is not limited to the UK market as six of the top ten global healthcare services deals in 2006 also involved private equity. These deals included Apax's acquisition of Capio AB and BC Partners' acquisition of Medica.

Private equity interest continues to fuel growth in deal values across the healthcare spectrum. These investors are attracted by the ongoing opportunities to consolidate the market as well as favourable long term macroeconomic and demographic drivers. In 2006 private equity accounted for less than 30% of the number of healthcare deals, but over 90% of disclosed healthcare deals by value.



Source: Dealogic, Mergermarket, Reuters, PwC analysis

While debt markets have remained favourable many deals have required ever smaller equity investments. In addition, property investors are prepared to accept a lower return than equity houses, and this has allowed private equity houses to restructure their investments post deal by splitting the operating company from the property company.

Hospitals

The hospitals sector was active during 2006 and has maintained this trend into 2007.

2006 saw Netcare UK and Apax's £2.2bn acquisition of General Healthcare Group, the largest healthcare transaction of 2006. Netcare, a leading player in the South African healthcare market, first entered the UK market through participation in the Department of Health's ISTC programmes. Now the company plans to expand its activities in the UK working in partnership with the NHS, and to develop its services in Continental Europe.

The £1.4bn sale of BUPA's hospitals division to Cinven is the largest UK healthcare services deal to date in 2007. This transaction follows on from Cinven's previous investments in General Healthcare and Générale de Santé. The hospital group is to be rebranded as Spire Healthcare later this year.

Following this transaction BUPA plans to focus on its insurance and care homes business both in the UK and overseas. It recently announced its interest in entering into a transaction with a major Australian private health insurer.

Cinven fought off competition from a number of other bidders, both private equity houses and overseas trade players. Now that Spire Healthcare has joined BMI, Capio, HCA, and Classic Hospitals to become a private equity backed hospital group, the role of private equity in the provision of UK healthcare has been brought into sharper focus for politicians and trade unions.

With an ageing and increasingly affluent population and increased NHS outsourcing opportunities, the private equity interest in hospital assets is set to continue. Overseas providers who missed out on BUPA Hospitals are rumoured to be looking at a number of hospital assets currently up for sale, including Capio UK.

The interest in hospital assets is not confined to the UK. In June 2007 Barclays Private Equity backed the buyout of MediPartenaires, the French acute hospital group, in a deal valued at nearly £400m.

Activity has also increased in related sectors. In June 2007 Davis Service Group acquired the sterile medical consumables and decontamination business of InHealth Group Ltd, and in May 2007 ISIS Equity Partners backed the buyout of Williams Medical Supplies, a leading supplier of medical supplies to the primary care market.

Elderly care –

competition between trade consolidators

Private equity backed trade players and corporates continue to be active in the elderly care sector. In 2006 Three Delta's £1.4bn acquisition of Four Seasons Health Care was the second largest transaction of the year.

Within the elderly care market a handful of key players are driving the consolidation of the market. These include Southern Cross Healthcare Group plc, BUPA, Barchester Healthcare (backed by Lydian Capital) and Four Seasons Health Care (backed by Three Delta). With only limited growth achievable through fee rate rises, either the development or acquisition of new beds remains a key growth driver for care companies.

Southern Cross has been particularly active in 2007 having acquired a number of companies including the operating business of Lifestyle Care, and a portfolio of 15 care homes from Avery Healthcare. Southern Cross is expected to sell the freehold property of the Avery homes allowing it to benefit from the strong investor demand for property assets.

Despite the emergence of these large trade players the mid-tier sector remains active in its own right. A number of equity houses have been working to build up mid-sized chains, for example August Equity's Healthcare Homes Group. Their strategy has been to build up a sizeable business through the acquisition of individual homes or small groups with the aim of a multiple arbitrage upon exit, most likely to one of the trade consolidators – as Graphite Capital did by selling off the majority of Avery Healthcare to Southern Cross.

We expect future deals within the elderly care sector to be driven by trade players keen to continue their consolidation of the elderly and specialist care markets by expanding their geographical footprint. Despite consolidation in the sector Southern Cross, the market leader, still only has an approximate 7% market share.

A return to the public markets?

2006 witnessed the successful IPO of Southern Cross Healthcare, allowing a phased exit for its private equity investor, Blackstone.

Prior to IPO Southern Cross adopted an opco model, selling its freehold properties to enable it to achieve a reduced level of debt consistent with quoted status. Post IPO performance has been strong, with public markets keen to invest in the sector. We expect to see further IPOs of private equity backed care companies who will look at Southern Cross and Caretech's share price performances, and view an IPO as an attractive exit route.

Supported living and domiciliary care – the next emerging markets?

By deal volume the most active sector in 2006 was the domiciliary care and supported living market. This market accounted for 13 out of the 38 deals in the UK healthcare sector.

However, their total deal value at just £102m is evidence of the continued fragmented nature of this market.

While a few mid-tier trade players are active in M&A, such as Claimar Care and Careforce – the latter acquired by Mears Group in early 2007 – to date there has been limited private equity involvement, in particular due to the difficulty in finding an appropriate platform in which to invest.

Recent transactions – Isis Equity Partners' acquisition of Paragon Healthcare (UK) Ltd, Sovereign Capital's acquisition of Parallel Options, and in July 2007 August Equity's buyout of Lifeways – suggest that this may be changing and that consolidation in this sector will increase. With an expected slow down in public sector spending from 2008, supported living, which offers a less costly model than residential care, may well be an attractive sector to back.

Two of the largest companies in the domiciliary care sector are Clinovia and Healthcare at Home. Clinovia was sold by Lyceum Capital to BUPA in 2006, and Healthcare at Home, which has been a long-standing Apax investment, was sold to Hutton Collins in July 2007.

Outlook

Overall the UK healthcare services M&A market remains strong. To date interest rate rises do not seem to have dampened M&A activity, but for how long?

While some investors and commentators believe that prices are close to a peak, in general investors' appetites have not been diminished.

The private equity sector remains attracted to the healthcare sector due to fundamental growth drivers and, with a wall of money to spend, equity houses are expected to remain keen bidders for high quality assets. Whilst some sub-sectors may see less activity new sectors will continue to emerge.

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