



European Healthcare

A thought leadership publication from GE Healthcare Financial Services in association with mergermarket





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Foreword

M&A activity in the healthcare sector is showing no sign of dwindling. Indeed, in the past three years the sector, which comprises medical technology and devices, pharmaceuticals, hospitals and other services, and biotechnology, has remained a focus for M&A activity, with some 2,569 M&A transactions globally worth €477bn, according to mergermarket. Furthermore, around a third of these deals in both value and volume terms have involved target companies in Europe.



The European sector also remains a particularly attractive arena for private equity funds and other associated financial investors, who are drawn by Europe's ageing population and the supply demand imbalance found especially in the services sector. To illustrate this one can look over the past three years, where almost half of all financial buyouts involving healthcare companies have been based in Europe. Furthermore, post credit crunch, forward deal prospects look resilient, especially in the mid market (<€500m) deal space. At the same time, large established pharma companies are facing deteriorating fundamentals with weak pipelines, patent cliffs in 2011/12, patent challenges from generics companies and a hostile regulatory environment, and in being forced to adapt to and accommodate generics companies and cutting-edge biological treatment developers. In other parts of the healthcare industry, the technological innovation in biological medicine and associated diagnostic device technologies holds out a near future of ever more sophisticated personalised and pre-emptive treatments.

In an attempt to delve deeper into some of the seismic forces shaping the European healthcare market, we commissioned mergermarket to investigate the shifting M&A landscape as charted by their proprietary deal database. At the same time, mergermarket journalists were given access to leading healthcare experts from GE to talk about their views on the key industry drivers within the various segments of the industry. We have also used this report to present three case studies of investments made by GE Healthcare Financial Services.

We hope you enjoy this first edition of European Healthcare and we welcome your feedback.

Stephan Caron

Executive Director, Leveraged Finance and Life Sciences
GE Healthcare Financial Services

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We think our results speak for themselves, winning a number of high profile deals since the crunch began, including one of the largest European LBO deals in Firth Rixson. For more information on how GE Commercial Finance can help you win, contact:

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€564,000,000 July 2007 Senior, Second Lien & Mezzanine Facilities Acquisition of Gambro Healthcare by Bridgepoint Mandated Lead Arranger 	€110,000,000 Aug 2007 Senior Facilities Spin-off of Nucletron from Deift Instruments Sole Mandated Lead Arranger & Sole Bookrunner
\$507,000,000 Nov 2007 Co-Lead Arranger Acquisition of Qualitest Pharmaceuticals by Apax Partners Syndication Agent 	£450,000,000 Dec 2007 Senior Facilities Acquisition of Firth Rixson by Oak Hill Capital Partners Joint Mandated Lead Arranger & Bookrunner
£91,000,000 Pending Senior Facilities Acquisition of Classic Hospitals by Cinven Mandated Lead Arranger 	\$220,000,000 Pending Senior Facilities Acquisition of Active Pharmaceutical Ingredients by 3i Global Coordinator Bookrunner & Mandated Lead Arranger



European Healthcare

Based on an interview with Stephan Caron, Executive Director of Leveraged Finance and Life Sciences for GE Healthcare Financial Services Europe

Is European healthcare recession-proof?

In Europe there is currently significant concern over the impact of a possible US recession and the ongoing fallout from the global credit squeeze. However, despite ever-gloomier headlines in the UK, the situation in continental Europe appears somewhat more stable. While the deteriorating world economic outlook has led to growth forecasts being revised downwards, the Euro is still very strong and overall European unemployment levels are their lowest for 25 years, reducing fears of a slowdown in consumer spending.

Against this backdrop, many investors argue that the majority of healthcare companies are largely immune from conditions in the wider economy. This they say is because the companies generally have limited exposure to direct consumer spending. Nevertheless, socio-political conditions can and do have an important impact on companies in the sector. As Stephan Caron, healthcare expert with GE Healthcare Financial Services, points out, while it may be true that certain areas of healthcare are recession proof, there are still many parts of the market which are regulated or influenced by government reimbursements (e.g. pharma, medical technology and devices, and services). In addition, there are several sub-segments where discretionary spending plays a bigger role and which may be impacted by a recession, such as cosmetic surgery, eye laser surgery, screening centres, nutritional supplements and herbal plants. However, many experts argue that the penetration of these sub-segments in most European countries is relatively low which may provide some down-side protection in a recessionary environment.

Drivers of M&A in healthcare

Another well-touted reason to be optimistic about the European healthcare sector is that healthcare spending in Europe is still below the US average (8.1% of GDP in UK and Spain, 10.6% in France, and 10.6% in Germany compared to 15.3% in the USA). However, as Caron underlines, it is also the case that most European economies are facing increasing pressure to reduce public deficits. Furthermore, the resulting lower tax revenue from decreased economic activity is likely to put further constraints on government spending. There is also recognition within most countries that inefficiencies within the public sector should be tackled as a way to curb the level of spending in healthcare.

As a result, a consistent theme in many European countries has been an increase in the level of outsourcing or outright privatisation of healthcare, in particular in the hospital and nursing home sector. In the UK for instance, the government has favoured shifting NHS work to the private sector as a way to reduce waiting lists. The trend is expected to continue in the UK with the Patient Choice Agenda and Extended Choice Network. The Nordic countries are also increasingly outsourcing public services to the private sector. Meanwhile, DRGs (Diagnosis Related Groups) which favour more efficient private operators have been introduced in France and in Germany. The German market has also seen outright privatisations of large non-performing public hospitals to leading private operators with strong domestic reputations.

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The challenges in pharma; opportunities in medtech and devices

Outside of healthcare services, the pharmaceutical sector is also under scrutiny with reimbursements coming under pressure in a number of European countries. This is driven by governments trying to cut drug expenditure (one of the largest areas of spending in the healthcare budget) to spend money elsewhere. Caron believes this cost pressure, coupled with ongoing consolidation and further penetration of generic drugs, will continue to increase the market potential for generics players. Caron believes that large pharma will continue to suffer from weak pipelines, patent expirations and the tighter regulatory environment. The regulatory agenda, in particular at the EU level, appears to be driven by concerns about the rising costs of medicines and declining innovation. At the same time, dawn raids by the European Commission have started to hit large pharma and also generic players in Q1 2008.

Caron is more positive about the medtech and devices area, pointing out new technologies and reimbursements as the main value drivers. He does not see instant “blockbusters” on the horizon, but rather “on-going upgrades to existing technologies”, in particular “a bigger focus on molecular diagnostics, preventative medicine and also point-of-care testing – especially in the in-vitro diagnostics market.” There are also likely to be continued opportunities to outsource manufacturing to low-cost countries such as India and China. All of these factors, Caron believes, should continue to support top-line growth in the medical devices sector.

Big deals in 2007

Pharma: M&A in generics

The three largest transactions in 2007 came from the generic drugs sector. Akzo Nobel, a Netherlands-based company focused on chemicals, coatings and healthcare, had been saying for nearly a year that it intended to IPO its pharma business (aka Organon) in a two-staged deal. The company engaged Morgan Stanley and ABN Amro to advise. Proceeds were likely to go towards acquisitions for the other parts of the Akzo business viewed as more core .

Organon had fairly steady product lines, predominantly in the women’s health and anaesthesia areas and was expected to be facing some patent expirations in 2008-2010 with some of the smaller products in its portfolio. At the time, several private equity houses felt that the business could have been an attractive LBO candidate and were disillusioned when it was finally sold to Schering Plough, the US trade buyer, for €11bn in March. The valuation represented an EV/EBITDA multiple of around 22x, well-above the amount any private equity investor was likely to have been prepared to pay.

A similar outcome happened with Merck Generics of Germany, which was auctioned by Bear Stearns. The sale of the business was likely being used to help cut debt that Merck took on to finance its purchase of Swiss group Serono, Europe’s biggest biotech company. Merck’s generics business had sales of €1.8bn in 2006, ranking the unit fourth in the world behind Teva, Novartis AG’s Sandoz unit and Barr Pharmaceuticals. Several strategic bidders and leading private equity houses were highly interested in acquiring the business, taking the view that it offered a large scaleable platform providing access to attractive markets, (e.g. France, UK, and US) and the opportunity to generate many operating efficiencies. However, once again private equity houses and other strategic bidders were priced out as Mylan Inc. from the US paid €4.9bn, in a deal that was at the high end of price expectations.

The final act in the generics sector came a few months later when Actavis, the Iceland based generics firm, was taken private by Novator for €3.5bn. Novator is a newly established UK-based alternative investment firm founded by a wealthy Icelandic entrepreneur who already had a significant stake in the business.

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Healthcare services

The services sector was also very active in 2007 with two large transactions in the acute care space. In June, BUPA was sold to Cinven for €2.1bn. A few months later Hirslanden, which was owned by BC Partners, was sold to MediClinic from South Africa, right at the time when the credit markets were turning. Both transactions commanded very high multiples (in excess of 14x) which were achieved with the benefit of very competitive Opco-propco debt structures.

Medtech and devices

In the medtech and devices sector, Mölnlycke, a global single-use medical products company headquartered in Sweden, which manufactures and sells wound care and surgical products, was acquired by Investor AB and Morgan Stanley Principal Investments (MSPI) in January for €2.85bn. Both investors have a strong track-record in healthcare: Investor AB has investments in Gambro AB and AstraZeneca while recent MSPI healthcare investments include Grifols and US Oncology.

Finally one of the few remaining large UK medtech companies, Gyrus Group, was sold to Olympus. The bid valued Gyrus at an enterprise value of £1bn (€1.4bn) representing 3.9x 2008 EV/sales and 30.8x 2008 EPS. The two companies have complementary technologies, particularly in the urology/gynaecology area.

IPOs in pharma

2007 delivered a strong year for equity capital markets with a total of 115 deals raising €11bn according to research from Rothschild. The pharma sector in particular generated several successful IPOs in 2007 despite the relative underperformance of the sector. The pan-EU drug sector underperformed the market by 13% in 2007 and 12% in 2006 as fundamentals continued to deteriorate and significantly better growth opportunities existed elsewhere. Nevertheless, Caron believes that with a more severe general economic outlook for 2008, the relative defensiveness of pharma (strong balance sheets, limited consumer exposure, high free cash flow yield) should help the sector to perform better in 2008.

Caron provides Almirall (a leading Spanish pharma business) as a good example of this trend. Almirall was IPO'd in June 2007 and was one of the top performing European mid cap pharma stocks for H2 07, outperforming MSCI Europe and MSCI European Pharmaceuticals by 11% before underperforming more recently due to an absence of newsflow. Laboratorios Farmaceuticos Rovi (a leading Spanish specialty pharma company) also had a successful IPO in December 2007 on the Madrid Stock Exchange. Other successful IPOs in the pharma sector include DiaSorin, an Italian Specialty pharma company, which raised €250m in July 07 and Pharmastandard, a Russian generics business, which raised €698m in May 2007 and has been the best performing healthcare company of those IPO'd in 2007.

On the services side, Clinica Baviera, the leading provider of refractive surgery and other ophthalmic treatments in Spain, was successfully IPO'd on the Madrid Stock Exchange in April 2007 raising €108m. The transaction was structured so that 3i would divest its 32% stake, and the founding family would reduce its stake, from 40% to currently 31%. The stock had a strong performance in H1 2007 (+30%) before dropping back to its IPO price in February 2008.

Top private equity deals

Cinven was very active over the summer of 2007 with the acquisition of two hospital groups, BUPA hospitals in the UK (now rebranded Spire) and USP Hospitales in Spain. Interestingly, these are stand-alone investments and Cinven has no plans to combine the two companies, appearing to have learnt from the Capio Group, which struggled in its attempt to create a pan-European hospital group. Instead, it seems Cinven favours a domestic buy and build strategy: following the BUPA acquisition in 2007 Cinven bought Classic Hospitals, another UK hospital chain, for €193m in early 2008. Aside from these deals, Cinven has significant experience in the private healthcare market: it also currently owns Partnerships in Care, the UK's leading provider of specialist mental health and related services which operates 940 beds in its 17 facilities around the UK and had previous investments in Générale de Santé (the leading private acute care hospital provider in France) and General Healthcare Group. Cinven combined General Healthcare with Amicus in 1997 in what was Europe's first £1bn leveraged buyout to create the market leader in the UK private healthcare sector. Cinven exited this investment in 2000.

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Otherwise, back in 2007, there was the €2.85bn sale of Swedish surgical and wound care equipment company Mölnlycke Health Care Group to Investor AB and MSPI (already mentioned above). Investor has a strong track record in the healthcare sector, both within its venture capital arm Investor Growth Capital, within Operating Investments with Gambro AB as well as within its Core Investment AstraZeneca. Recent MSPI healthcare investments, meanwhile, include Grifols and US Oncology. In the auction for Mölnlycke, Investor and MSPI beat out competition from several other leading private equity players. The vendor, Apax, had acquired Mölnlycke from Nordic Capital in July 2005 and merged it with two of Apax's existing portfolio companies, Regent Medical and Medlock. Apax then embarked on a dual-track sale or IPO process hiring Deutsche Bank to advise on both possibilities, with Goldman Sachs and Merrill Lynch also advising on the IPO side.

The UK specialist care market

The UK market continued to see significant activity in the specialist care market, with a number of mid market and smaller deals across the sector in 2007. The largest of these was Care Principles, which operates low to medium secure facilities for patients with learning disabilities, personality disorders or autistic spectrum disorders. Care Principles was sold by 3i to Qatar backed property investment vehicle Three Delta for £285m (€399m) in July 2007. Led by Paul Taylor this was Three Delta's third UK acquisition following their buyout of Four Seasons, the elderly care group, and Senad, the specialist schools group, in 2006. Elsewhere in the specialist sector, Castlebeck, which was bought by Lydian Capital in 2006, continued to acquire and bought Mental Health Care for £270m (€377m). Elsewhere, Hutton Collins made their second investment in the healthcare sector, by acquiring Healthcare at Home from Apax for €296m. Healthcare at Home is the UK market leader in the provision of complex home healthcare services.



According to Caron, private equity activity in 2007 and valuations were largely underpinned by increased asset backed leverage and the use of Opco-propco structures. This was particularly true in the services sector. Another common feature, in particular before the credit crunch, was the use of the concept of "proforma mature run-rate EBITDA" when selling services businesses in the residential or specialist care sector. Caron believes that going forward lenders will now be much more conservative on run-rate lending multiples.

Exits

Most exits in 2007 were driven by secondary or tertiary buyouts by private equity investors with exit multiples in excess of entry multiples. Caron feels that these secondary and tertiary buyouts were symptomatic of the vast amounts of liquidity being available to support private buyouts until the second half of 2007, combined with the fact that most PE houses had raised record-breaking funds. Whilst Caron expects exit multiples on non asset-backed deals to generate decent returns to investors, he believes that exits on asset-backed transactions which were completed over the past two to three years with the support of very high debt packages will be more challenging.

Trade buyers will also likely play a much more significant role in 2008. Indeed, Caron points to several transactions in H2 2007 that exemplify the more prevalent role of strategic buyers: Capio UK (hospital chain) was acquired by Ramsay of Australia, Nuffield's non-core hospitals were bought by Netcare of South Africa, and Avery Care (elderly care) was bought by Southern Cross.

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Opportunities for financial buyers in 2008?

Looking forward, post credit-crunch, Caron expects to see a significant drop in the number of large buyouts and also fewer secondary or tertiary buyouts as a result of the current situation in the debt markets. Indeed, as he points out, most companies which traded over the past 12-18 months at very high multiples with competitive debt packages would not be able to raise as much debt financing in today's markets, certainly not until the banks have cleared the estimated €50+bn worth of transactions that remain hung as a result of the credit-crunch. However, Caron does expect to see continued activity in the mid-market healthcare segment across Europe and points to several sale mandates that were awarded Q1 2008 as evidence of that trend. In particular: FutureLab (a leading private lab business in Central and Eastern Europe currently privately owned will be sold by UBS); Euromedic (a leading diagnostic and dialysis provider in Central and Eastern Europe owned by Warburg Pincus being sold by Rothschild) and Ambea (a leading outpatient clinics and nursing home group in the Nordic Region to be sold by Morgan Stanley). Additionally, Craegmoor (a UK specialist care business) is also expected to be put up for sale some time in 2008.

Caron believes that the dynamics of deal making have changed with banks now focusing much more on the credit fundamentals i.e. can businesses repay their debt in three/five/seven years? The result is much more deal flow emerging in the lower mid-market, with companies such as Casa Reha (a nursing home group in Germany acquired by HG Capital in January 2008), IDH (a UK dental practice group acquired by Merrill Lynch in February 2008), Classic Hospitals, (a UK hospital group acquired by Cinven in February 2008), and Active Pharmaceutical Ingredients (a division of NYSE-listed Alpharma Inc and leading company in the fast-growing injectable generics market acquired by 3i in February 2008). One interesting development Caron highlights is that most deals which have emerged in 2008 are being financed on a "club basis" with private equity houses playing an active role in ensuring that the debt is pre-placed with a select group of banks to reduce the syndication risk.

Outlook

Looking forward, Caron underlines that M&A in healthcare continues to be a very competitive landscape with bidders paying multiples well in excess of any other sector. In his view it is critical that those companies continue to deliver on the growth promises for buyers to justify such premiums. While few private equity players have lost any significant money in recent years there may come a day when governments start cutting reimbursements in certain segments of the market. As Caron says: "Few people remember now that the UK long term care market went through a period of doom in the late 90s when many small players went bankrupt as a result of low reimbursements and rising costs resulting from minimum wage increases and tighter regulatory standards." While many such players in that market are now much larger and more professional, Caron feels that they are also backed by aggressive debt structures with very little head-room to support a market correction. In general, he expects that the hold period for transactions which were closed pre-market correction will increase significantly to enable those companies to reduce their debt levels.

The credit crunch is likely to drive valuations down in particular in the healthcare services sector where valuations were to a large extent driven by Opco-propco debt structures. Some segments of the smaller end of the market may resist downward pressure when financial investors or trade buyers are looking at portfolio add-ons to their existing investments. Alternatively, investors may be prepared to accept lower returns or longer hold periods. Several recent transactions have demonstrated that financial sponsors are prepared to line up a larger portion of equity to remain competitive in a bid process.

Overall, however, Caron remains positive overall about the outlook for healthcare across Europe. "Most investors continue to view the healthcare asset class as more stable and offering higher growth prospects in a context of general macro-economic gloom. Therefore we expect continued activity in 2008 albeit at a lower level than 2007 and primarily with mid-market private equity backed transactions (below €500m) across all segments of healthcare. Large cap transactions (above €500m) will be more challenging for private equity players unless debt markets improve significantly which we don't expect in the near term, and so we are likely to see trade buyers play a much bigger role this year."

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Based on an interview with Stephan Caron, Executive Director of Leveraged Finance and Life Sciences for GE Healthcare Financial Services

Key M&A trends: bigger is better

Whilst M&A moves by large pharma and biotech companies attract significant attention, M&A among medical technology and device (medtech) manufacturers has also grown in significance both in terms of volume and absolute value of deals undertaken in the past few years.

This means that today many of the larger subsectors of the medical technology and device (medtech) universe are fairly consolidated, with more than three-quarters of the market held by a handful of companies. In the mid to late 1990s, for instance, consolidation occurred within the cardiac rhythm management, interventional cardiology, and orthopaedic industries. Over the past three years, intense consolidation has also occurred within the diagnostic industry, driven by giants such as GE Healthcare, Siemens & Philips.

M&A activity has been driven by many factors. In the 1990s, consolidation was mainly influenced by the desire to achieve greater scale and to better position companies in an evolving healthcare environment. The orthopaedic manufacturers, for example, consolidated to counter the increasing power of hospitals and buying groups. In addition to greater scale, many companies also sought greater product and geographic sales diversification. They appear to have concluded that without scale and diversification, their ability to compete in a tougher regulatory environment may be limited. In recent years, the European companies that have been most active in M&A include the “usual medtech suspects” such as Siemens, Philips, Smith & Nephew as well as private equity funds.

Stephan Caron, healthcare expert with GE Healthcare Financial Services, expects continued sectoral consolidation for several reasons. The first is that it is becoming more and more difficult for small and midsize medtech companies without scale to compete in an environment where their customers, hospitals in particular, are trying to minimise their supply costs. Hospitals have become much more effective at implementing central purchasing initiatives. More efficient procurement projects from public healthcare bodies, a prime example of such activity being the e-auctions used by the National Health Service in the UK, also illustrate the amount of pricing pressure for commoditised products.

Another driver of consolidation is the ever more conservative nature of European regulators, which is mirroring the tougher stance of the FDA in the US. As Caron observes: “In both the pharmaceutical and medtech spaces, we are seeing a trend towards more conservatism in the approval process with an increased focus on assessing the safety and efficacy of new drugs and medical products. This leads to longer and more costly approval processes. Gaining scale through M&A is one way to mitigate this cost.”

The influence of technology

Despite the pressure to consolidate, significant technological innovation has occurred over the past two years in the medtech sector, driven by both improved growth prospects as well as changes to the regulatory and reimbursement environment. As Caron underlines: “This innovation is all the more imperative given the growing saturation and maturation of several traditional growth markets such as dialysis machine and diagnostic scanners. The focus now is on the use of non-invasive devices and increased access to point-of-care testing, in particular for in-vitro diagnostics in the treatment of diabetes and allergy testing.”

As in other areas of healthcare, the lure of emerging markets also offers attractive growth opportunities for medtech players.



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As an illustration, while the penetration rate of MRI scanners is already over 30 per million of population in the US, it is 15 in Germany, 8 in the UK and much lower in Central and Eastern Europe. This level of low market saturation obviously offers attractive medium-term growth potential for device manufacturers. Meanwhile, other segments, such as hearing aids, are expected to accelerate from existing growth rates of around 6-7% to 7-9% over the next five years, driven by demographic trends, increasing incidence of hearing impairment, rising adoption rates and increased binaural devices. Advanced wound care – in particular foams – is another area that should see attractive growth rates at the expense of traditional wound care products. The growth in sales of advanced wound care products is driven by both increasing incidence of chronic wounds and by increasing penetration of advanced products, particularly in home care settings.

A counter-cyclical sector

In general, M&A in most areas of healthcare is held up as relatively insulated from wider economic trends and fluctuations. As Caron underlines, “The medtech sector in general should resist quite well in a recessionary environment, however certain sub-segments such as dental implants and corrective lenses are, for the most part, not reimbursed in Europe (or the US) and might be more exposed to an economic slowdown.”

Certainly, medtech companies have seen encouraging levels of deal flow in the past year, in particular within the Swedish market, with financial buyers also relatively prominent. Indeed, as Caron describes, “in the first half of 2007, the prevailing attitude among financial buyers was that no one was immune to a buyout, whatever the size.” The year’s largest European deal, which occurred in January 2007, saw Morgan Stanley Principal Investments and Investor AB, the Swedish private equity firm, agree to acquire Mölnlycke Health Care AB, the Swedish manufacturer of surgical products. The deal was a secondary buyout from Apax Partners, and had an enterprise value of €2.85bn. The auction was competitive with many other private equity funds also bidding.

February, meanwhile, saw EQT Partners, the Swedish private equity firm, agree to acquire Dako, a Danish privately-owned world leader in cancer diagnostics, for €973m. The auction was run by Goldman Sachs and adds to the list of other healthcare deals that EQT has completed over the past few years and which includes Gambro AB, Aleris and Carl Zeiss.

Just before the credit crunch hit in July, Montagu Private Equity agreed to back the secondary management buyout of Sebia International, the French manufacturer of reagents and automated diagnostic equipment, for €400m. Montagu was joined in the deal by ICG and Astorg Partners, the French private equity firm and current owner.

Somewhat inevitably, the transaction environment changed significantly following the problems in the credit markets during July and August. Since last summer, it has become accepted wisdom in the market that larger private equity buyouts financed by syndicated loans will diminish substantially. As a result, very large deals in medtech can be expected to return to the domain of large, corporate buyers. For example, November 2007 saw Europe’s second largest device based transaction and it involved a strategic bidder. The deal in question saw Olympus Corporation, the Japanese precision machinery and instruments manufacturer, agree to acquire the entire share capital of Gyrus Group plc, the UK-listed medical device manufacturer for £935.6m (€1,435m). For Caron, however, this does not mean that we are unlikely to see smaller strategic or private equity deals in the future. On the contrary, he expects that “tuck-ins and add-ons that plug gaps in a corporate buyer’s strategy or a private equity backed portfolio company are likely to become more prevalent”.

There was, however, one exception. Despite the credit crunch, November saw a sizeable secondary buyout in the form of the €863m acquisition of Alliance Medical by Dubai Investment Capital (DIC). Alliance, based in Warwickshire, England, was founded in 1989 by Robert Waley-Cohen and provides a range of diagnostic imaging services used in hospitals across Europe as well as managing static and mobile scanners. In the past six years, Alliance Medical has consolidated its UK market position and expanded into continental Europe through 16 acquisitions, most notably in Ireland, Italy, Germany, the Netherlands and Spain. Alliance Medical operates more than 140 scanners and reported revenue of £132m for the year ended 31 March 2007. Bridgepoint, who acquired the business from 3i in 2001,

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attempted to sell the company in 2006, with prices rumoured at that time to be in the £400m-£500m range, but the sale process eventually failed and rather than re-launch a full-blown auction, they were able to attract an investor from the Middle East in the form of DIC, in a pre-emptive sale at the end of last year.

As Caron says, “the higher price tag demonstrated that it is sometimes necessary to invest for a longer hold period.” DIC has indicated that it is keen to explore new routes for growth and to provide access to new markets, such as the Arabian Gulf and the broader Asian region.

This deal aside, Caron’s expectation is that M&A in medtech will continue to be strong in 2008 and that the bulk of transaction volumes will be in the middle to lower-middle market (<€500m). As Caron points out, one of the main drivers of M&A activity in medtech will continue to be that many European companies, especially in Germany, are in the hands of owners at or near retirement age, and a sizeable group of large financially-strong industrial component manufacturers are aggressively seeking acquisitions. Simply stated, there is a substantial number of small and medium-sized medical device and component companies that have products or technologies that make them attractive acquisition targets for a large group of very motivated potential buyers, both strategic and financial.

Looking forward, Caron holds high hopes that Euromedic, a leading provider of diagnostic and dialysis services across Europe, founded by Joseph Priel and currently owned by Warburg Pincus, GE and management, will take advantage of the market’s appetite for this type of business to attract bidders hungry for quality healthcare assets with high growth prospects. Rothschild was mandated to manage the sale process of Euromedic in Q1 2008, adding to the long list of sale mandates that Dominic Hollamby, the Global Head of Healthcare at Rothschild, has won in the services sector over the past few years.

The future in medtech: diagnostics for biologics

As mentioned earlier, innovation is key to medtech and the introduction of new products has been a strong stimulus for growth in the sector. The flipside of this innovation curve is that technologies can often come and go with relative regularity. For example, over the past two years, implantable device sales growth has significantly decelerated: implantable cardioverter defibrillator (ICD) market growth collapsed following recall issues in 2005, and the stent market dropped

after safety concerns about its products. At the same time, artificial hip and knee demand remains healthy in terms of unit growth, but pricing has decelerated. Looking forward, Caron does not expect any near-term breakthrough technology similar to drug-eluting stents and cardiac resynchronisation defibrillators. Instead, his expectations are that any market opportunities that emerge will be significant on a company-specific basis.

Perhaps the most exciting area in medtech is the potential for it to support advances in cutting edge biological pharmaceutical treatments. Molecular diagnostics, in particular, is on the verge of some major breakthroughs, with the mapping of the human genome and more advanced testing platforms that will allow the discovery of the fundamental markers of disease and the predisposition of individual patients to them. This has led to the development of more targeted therapies together with complementary diagnostic tests. Simply put, the future will be one where tests will identify an individual’s predisposition to disease, detect the presence of that disease at a molecular level, identify the best therapy and then monitor compliance with that therapy. Clearly the involvement of diagnostic device manufacturers in this area will be a crucial opportunity.

Centralisation or point of care diagnostics?

The monitoring of the effectiveness of a therapy and patient compliance is fundamental to a successful outcome in chronic diseases such as diabetes. In Europe, there are currently two main trends in the delivery of laboratory medicine services: the centralisation of lab services and the increasing use of automation in core laboratories on the one hand, and the proliferation of point-of-care testing on the other. Technology is available to facilitate both these trends.

At this stage, Caron can see the merit in both models for delivering treatment. “Enhanced sample processing, power-linked to tracking systems and pre-analytical sample preparation stations, make the automated core lab a reality, while the development of miniaturisation and micro-fabrication processes means that point-of-care testing for virtually any analyte is now available.” At present, Caron believes these services are being reorganised to put patients first. In the future, more care will be delivered in the primary care

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environment, and secondary care will be organised to make patient visits more effective.

Predictably, the biggest challenge for making this utopian model work is IT. Innovations in IT coupled with well-organised logistics will be required if the revolution in diagnostics is to take place. However, in many European territories the healthcare sector seems to lag in this area. This is undoubtedly having an adverse impact on the application of efficient diagnostics and, more importantly, on patient outcomes. As Caron explains, "Errors occur in test requests, sample identification and delivery as well as in the transmission of results. The great challenge is to use information technology to link test results to knowledge, and thereby support both the doctor and the patient in making the best use of test results." Despite the clear challenges ahead however, the fact is that many healthcare systems across Europe have already engaged in major IT investments to address some of these issues and to improve access to secure patient data.

Other areas to watch in medtech

Another area that GE identifies as a forward opportunity is in oncology. At present, the radiation therapy market appears to be growing at a healthy rate of between 10-12%, accompanied by a favourable reimbursement environment, the growing global incidence of cancer, and an increasing demand for minimally, or non-invasive, alternatives to existing cancer treatments. Other demand factors are growing patient awareness of treatment options and a requirement for treatments with fewer complications and side-effects, and shorter hospital stay and recovery times as opposed to radical procedures such as major surgery, where feasible. As Caron explains, it is this favourable outlook for radiotherapy that underpins GE's investment in companies such as Nucletron, a global leader in brachytherapy treatment (see case study on page 13). PET-CT has also been a big growth driver in oncology. It is a relatively new modality in most countries across Europe and is quickly becoming the gold standard in oncology and finding new applications in cardiology and neurology. Simply put, the PET/CT scan is better able to determine what is happening when a tumour is detected, as well as what the morphology is, through the combination of functional and anatomical information. PET scans are now widely accepted as a reimbursable procedure by payors in many countries, which will significantly contribute to its increase in utilisation. As a result we expect double-digit growth over the next several years across Europe.

Another area to watch according to GE is transcatheter valves. Analysts from Credit Suisse believe that transcatheter valves will be one of the more interesting new products that could transform a mature market into a growth market. They see this market developing over time and, with the aid of second-generation devices, deem it could be the next big thing in cardiology.

Another area is any device aimed at monitoring and preventing hospital-acquired infections such as MRSA, with expectations of a strong increase in utilisation rates, particularly in countries such as the UK.

Increased regulatory scrutiny of cost effectiveness

Despite the obvious potential of medtech, an area of concern for Caron is the level that some European countries are now taking cost-effectiveness into consideration in their recommendations before approving a new product. As he says: "For example, the UK's National Institute for Health and Clinical Excellence issued draft guidance on the use of drug-eluting stents and found that, primarily on the basis of cost-effectiveness, the products were not recommended for use in percutaneous coronary interventions. There was a second meeting scheduled for 4 September 2007 that was then rescheduled to 6 November 2007, to allow time to assess recently-available data. We expect, in general, increased scrutiny from the regulators on new product introductions and more adoption of cost-effectiveness as an approach to address rising healthcare costs."

One problem is that there is no commonly agreed definition on cost-effectiveness or evidence-based healthcare. However, some official bodies (in the US in particular) have depicted it as the process of evaluating all treatment options for a patient to provide the least costly yet most effective treatment. This can involve the comparison of pharmaceutical therapy versus a medical device, versus a traditional surgical treatment. The other concern Caron has is that certain segments of the medtech market such as traditional wound-care are heavily commoditised and are likely to continue to suffer ongoing pricing pressure.

This bearish sentiment aside, the potential for medtech driven by ongoing innovation across healthcare is clearly significant within Europe. Furthermore, growth in the sector is bound to drive M&A transactions, by both leading players and financial buyers for the foreseeable future.

The future for medical technology and devices

Medical technology and devices M&A: top European deals in 2007

Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Deal Value EUR (m)
26/01/07	C	Molnlycke Health Care AB	Sweden	Investor AB; Morgan Stanley Principal Investments	Sweden; USA	Apax Partners	2,850
19/11/07	P	Gyrus Group plc	United Kingdom	Olympus Corporation	Japan		1,435
28/02/07	C	Dako A/S	Denmark	EQT Partners AB	Sweden	Harboe family; Novo Nordisk A/S	973
05/11/07		Alliance Medical Limited	United Kingdom	Dubai International Capital LLC	United Arab Emirates	Bridgepoint Capital Limited (Formerly NatWest Private Equity Partners)	863
12/03/07	C	Plus Orthopedics Holding AG	Switzerland	Smith & Nephew plc	United Kingdom		671
03/12/07	P	Bruker BioSpin Inc.; Bruker Biospin Invest AG; Bruker Physik GmbH	USA; Switzerland; Germany	Bruker BioSciences Corporation	USA		625
12/03/07	C	Plus Orthopedics Holding AG	Switzerland	Smith & Nephew plc	United Kingdom		671
01/07/05	C	Leica Microsystems AG	Germany	Danaher Corporation	USA	LM Investment	460
21/07/06	C	Sebia International SA	France	Intermediate Capital Group (ICG); Montagu Private Equity LLP (formerly HSBC Private Equity Limited)	United Kingdom	Astorg Partners	400
01/02/07	C	HemoCue AB	Sweden	Quest Diagnostics Incorporated	USA	EQT Partners AB	323
16/05/07	C	Diamed Holding AG (77.70% stake)	Switzerland	Bio-Rad Laboratories Inc	USA		289

Case Study: Nucletron



In August 2007, GE Commercial Finance was appointed sole mandated lead arranger and bookrunner to finance the management buy-out of Nucletron, a leading provider of specialist services to the radiation oncology market, from Delft Instruments.

How it started

Shortly after GE Commercial Finance launched its leveraged finance offering in the Netherlands in May 2007, GE was invited to pitch to provide acquisition financing for the management buy-out of Nucletron from its parent company, Delft Instruments.

AlpInvest and Advent had bought Delft Instruments in a public-to-private transaction in 2004, and decided to capitalise on their investment by selling its key subsidiaries. Nucletron was the last in a series of businesses that they sold or spun off, but differed from the previous disposals as the shareholders of Delft Instruments rolled their equity over into the new deal, also allowing the Nucletron management team to significantly increase its shareholding.

Given the scope of the transaction, two GE Commercial Finance businesses joined forces – GE Artesia Bank, with its dedicated leveraged finance team in the Netherlands; and GE Healthcare Financial Services, a pan-European financing provider focused on the healthcare industry – thus combining local knowledge with healthcare expertise. Together, they won the deal over local Dutch banks, a win that GE largely attributes to the strength of this joint approach and the positive impact it had on the relationship with Nucletron’s management team.

The rationale

Nucletron is a radiotherapy company that focuses on the development and sale of the world’s most innovative solutions for cancer treatment. It has been a market leader since its inception in 1974, and specialises in brachytherapy, a form of radiotherapy whereby a radioactive source is brought close to the target tissue via a natural or created channel. The treatment gives a high dose of radiotherapy directly into the tumour, thereby not affecting the healthy surrounding tissue.

GE carried out extensive due diligence on the sector and on Nucletron before committing to invest. This work was helped enormously by deep knowledge of the sector gleaned from one of GE Commercial Finance’s sister businesses, GE Healthcare, a global leader in diagnostics whose Oncura subsidiary is one of the biggest producers of iodine brachytherapy seeds. Overall, the due diligence highlighted three factors which were key to GE’s ultimate decision to invest:

- Firstly, the oncology market is growing rapidly, leading to an increasing demand for radiotherapy treatment. There was only one other competitor offering products in all four stages of the process (diagnostics, treatment planning, simulation and brachytherapy treatment), and this limited competition meant that Nucletron was strategically positioned in the market and would make an attractive acquisition in years to come.
- Secondly, although utilisation rates for Nucletron’s products were relatively low, due diligence determined that this could be ascribed to awareness and habit, rather than unwillingness amongst clinicians to use the product. Nucletron had historically been very focused on technology but had not complemented that with a strategic marketing campaign to raise awareness in the industry. GE believed that with strong execution of a solid marketing plan, the company could significantly increase penetration of the product.
- Finally, GE was impressed with Nucletron’s management team, in place since 2005.

The execution

When the deal was funded in August 2007 with €110m senior secured facilities provided by GE, Nucletron commented that they had been strongly in favour of GE winning the deal. “The GE team really understood our company,” noted David Imperiali, CEO of Nucletron. “We are a highly specialised business in a very regulated industry and GE’s knowledge of healthcare made getting up to speed a lot easier. Their expertise really added value,” he said.

GE continues to have a strong, constructive relationship with management that goes beyond the financing, and both parties regularly share knowledge on the industry and discuss the state and direction of the business.

Forces for change in the pharmaceutical sector

**Based on an interview with Jason Cohen,
senior vice president and pharmaceuticals analyst with GE Healthcare Financial Services**

There appears to be no cure for the ill-fated blockbuster drug. These billion dollar plus revenue generators, a product of the late 80s, drove industrial strategy and the large scale mergers witnessed in the latter half of the 90s and the early part of this century. But like all good things, the twenty-year exclusivity afforded to the owners of these products is coming to end, forcing many pharmaceutical companies to overhaul their business models. Meanwhile, the generic drug industry is aggressively trying to capitalise on the opportunity presented by the patent expirations of these ageing blockbusters. The increasing prominence of generics within the industry has created an environment that is ripe for M&A, according to GE's Jason Cohen. Indeed, one of the largest European deals of the year occurred in May 2007 and saw Mylan Inc., the listed US pharmaceutical company, win the auction to acquire the generics business of Merck, the listed German company, for €4.9bn.

A new paradigm

There was a brief moment in time when the preferred strategy for big pharma to combat the loss of exclusivity was to extend product lines through reformulation, better drug delivery and improved drug absorption. However, pricing pressures in Europe in the form of government caps on healthcare spending, along with the impact of managed care and the recent Medicare reforms in the US, has led to a more cost effective approach to formularies and drug dispensing. As a result, unless a drug within a particular therapeutic class shows some incremental benefit, patient access to that therapy may be restricted through limited formulary access or other means. The net effect has led to a crowding out of 'me-too' products and a natural bias towards generic products.

But pricing is one of only a number of different problems that big pharma currently faces. The business model upon which it founded the blockbuster approach is also being consigned to the dustbin. The mega mergers seen in the industry over the last decade were based on promises of increased R&D scale leading to improved pipeline output, but in reality were more to do with the combination of marketing muscle to maximise market share and geographical reach. Indeed, the past year's largest pharma deal in Europe was the €11bn acquisition by Schering-Plough of the US, of Organon Biosciences, a division of Dutch corporate Akzo Nobel; this deal is expected to add several key compounds to Schering's pipeline while increasing its R&D capabilities. Organon BioSciences is comprised primarily of Organon, a human health business, and Intervet, an animal health business. It also includes Nobilon, a human vaccine development unit, and Diosynth, a third-party manufacturing unit of Organon.

"A number of mergers were commercially successful in terms of acquiring growing products and entering certain attractive therapeutic areas, but from an R&D perspective they have proven less fruitful," Cohen says. He notes how the industry's top-heavy approach has stifled innovation through bureaucracy. On top of all this, he adds, there has been an increasingly aggressive approach being adopted by the generic drug industry. Indeed, many generic companies have ramped up their paragraph IV filings in a bid to invalidate drug patents before expiration, with increasingly brazen activity such as at-risk launches picking up over the last several years.

The net effect, Cohen points out, has been a realisation among the R&D firms that the industry has changed. Today's pharma sector is now about cost cutting, return on investment and lean sales strategies. Cohen also notes that there has recently been an increasing amount of outsourcing in both development and research functions by big pharma as a means of cutting costs to improve margins. The CRO¹ industry in particular has played a particularly vital role in this regard.

Forces for change in the pharmaceutical sector

Think small: think large proteins

The route out of the current malaise being selected by many leading pharma companies is to adopt more targeted drug development. Rather than pursue a scatter-gun approach to therapeutic specialties, many are expected to focus on fewer disease areas and, in some cases, move away from the general practice market altogether.

The early 90s success of the genome project and the advent of proteomics² has led to a better understanding of biological and chemical pathways in the human body, which in turn has led to the development of more specific treatments. The result has been an increasing use of antibodies and other large proteins to deliver better treatment outcomes.

“Biologics³ are something that pharmaceutical companies are looking to get into feet first for a number of different reasons,” Cohen says. Biologics for one thing have opened up a whole range of disease treatments that in some cases had not existed before, thereby conferring a certain degree of pricing power that many small molecule based drugs do not guarantee. Additionally, there is currently no clear regulatory pathway in the US that enables generic companies to file BLA licences⁴, and the challenge of demonstrating bioequivalence for copycat large molecule drugs is significantly greater than for small molecule generics.

Cohen believes that a regulatory framework for biogenerics⁵ will need to be addressed but will take a while to happen. Indeed, even if this was enacted by the FDA⁶ following a new US president in November, most generic makers seem to believe it is unlikely that the market will see a biogeneric approval for at least five years. This is because the immunogenicity problem⁷ will almost certainly involve some form of clinical testing on behalf of the generic company.

Wither the small molecule?

The focus by many firms on biologics does not necessarily spell the end of the small molecule. There will clearly be the need for this drug-based approach to continue targeting the chemical pathways that inhibit hypertension, diabetes and various types of neurological disease. Furthermore, as a product life cycle approach, the emerging economies of Eastern Europe, Asia and Latin America may provide new markets for companies looking to breathe new life into established product franchises.

M&A: the product of a genericised primary healthcare market

Cohen believes that these factors influencing the pharmaceutical sector will result in a net increase in M&A. The larger R&D firms will seek to increase their exposure to biologics through targeted, bolt-on acquisitions. What's more, the mistakes of the past will likely be heeded this time round with a more arms-length approach being adopted by acquirers in a bid to avoid any potential stifling of innovation.

“Larger companies are increasingly making acquisitions without forcing their culture on the new company,” Cohen says. “We are seeing more autonomous if not stand-alone relationships between the acquirer and target company.”

While a number of the larger biotechs may get taken out as part of this process, acquisition strategies will inevitably be more focused on products in earlier stages of development as competition for later-stage assets remains fierce, Cohen believes.



Forces for change in the pharmaceutical sector

Pricing pressures are not just being felt by R&D firms. Competition from lower manufacturing cost bases such as India and China has forced more established players in the generics space to expand through M&A in a bid to increase scale and gain access to new markets in pursuit of growth. Teva, Sandoz, Barr and Mylan are among a number of generic companies that have effected transactions in order to grow through such means.

With the primary healthcare market going generic over the next five years, M&A will prove to be a useful strategic

weapon for many generic firms to maintain scale and more importantly margins for a largely volume driven business. Cohen adds that this may also include the acquisition of technology that will enable differentiated dosage forms and formats akin to the product life cycle strategies more common in big pharma. As he says: "The generic industry is becoming largely commoditised so part of the rationale going forward is about being able to create products with relatively higher barriers to entry."

Pharmaceutical M&A: top European deals in 2007

Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Deal Value EUR (m)
12/03/07	P	Organon BioSciences N.V. (OBS)	Netherlands	Schering Plough Corporation	USA	Akzo Nobel NV	11,000
12/05/07	C	Merck Generics	Germany	Mylan Laboratories Inc.	USA	Merck KGaA	4,900
1/06/07	C	Actavis Group hf (formerly Pharmaco hf) (61.50% stake)	Iceland	Novator Partners LLP	United Kingdom		3,465
15/11/07	P	Polpharma SA (99.65% stake)	Poland	Gedeon Richter NyRt	Hungary	Genefar BV	884
9/02/07	C	UCB SA (7.58% stake)	Belgium	Financiere de Tubize	Belgium	Schwarz Vermögensverwaltung GmbH & Co KG	677
13/06/07	C	Madaus Pharma	Germany	Rottapharm s.p.a.	Italy	Droege International Group AG; Madaus Family	600
5/03/07	C	Eczacibasi Ozgun Kimyasal Urunler Sanayi ve Ticaret AS (75.00% stake); Eczacibasi Saglik Urunleri Sanayi ve Ticaret AS (75.00% stake)	Turkey	Zentiva NV	Czech Republic	EIS Eczacibasi Ilac Sanayi ve Ticaret AS	460
16/07/07	P	Hermal	Germany	Almirall-Prodesfarma SA	Spain	Reckitt Benckiser Plc	377
25/10/07	P	Recip AB	Sweden	Meda AB	Sweden	Recipharm	343
10/04/07	C	Ethypharm SA	France	Astorg Partners	France	Biovail Corporation; Gerard Leduc (private investor); Patrice Debregeas (private investor)	300

Source: mergemarket

- 1 Clinical research organisations are separate commercial entities commissioned by pharmaceutical companies to perform research-related functions.
- 2 Proteomics is the study of the set the proteins produced (expressed) by an organism, tissue, or cell, in particular tracking the changes in protein expression patterns in health and disease. Technologies such as mass spectrometry are used to detect protein biomarkers in the blood that may indicate early signs of disease, even before symptoms appear. Proteomics is often considered the next step in the study of biological systems, after genomics. It is much more complicated than genomics, mostly because while an organism's genome is rather constant, a proteome differs from cell to cell and constantly changes through its biochemical interactions with the genome and the environment.
- 3 Biological products (biologics) are those that are derived from a biological source, such as human plasma or cell culture, rather than synthesised from a chemical source. For example, for the treatment of psoriasis, biologics are available that specifically target the immune system and help lessen the symptoms of the disease.
- 4 Biologics license application: the required application for marketing a biologic product in the United States.
- 5 Biogenerics, are anticipated generic versions of previously patented biologic drugs.
- 6 The Food & Drug Administration is the US government agency that approves all drugs for marketing before they are made available to the public. The agency is responsible for enforcing laws on the manufacturing, testing and use of drugs and medical devices.
- 7 The concern that a biologic treatment that is not perfectly constructed might trigger the patient's immune system and thereby a rejection of the biologic drug.

Healthcare services going private

Based on an interview with **Stephan Caron, Executive Director of Leveraged Finance & Life Sciences for GE Healthcare Financial Services Europe**

The need for private involvement

In past years the European healthcare services sector has experienced significant consolidation, driven particularly by investor appetite for highly stable assets in the hospital, long-term care and specialist care space. Growth and M&A interest in the sector is centred on Europe's ageing demographic and patient-led demand for better services. The result of these factors is a supply-demand imbalance in many European countries. In France for instance the imbalance is expected to result in estimated bed shortages of between 60 to 100 thousand beds in the nursing home sector in the next 10 years. Furthermore, as in many other markets, in France it is expected that the for-profit sector will largely fill the gap. As a result the size of the French market for private commercial nursing homes is forecast to grow by around 5% per year in

value terms until 2011. A similar trend is visible in Sweden where outsourcing in the nursing home sector in Sweden is expected to grow from around 10% to 18% by 2011.

Many operators and investors in the sector are also drawn by the appeal of being able to increase prices above wage inflation. At the same though, it is expected that M&A in healthcare service will continue to be driven by the requirement of building scale and rationalisation, not least in order to protect businesses from pricing shocks. Signs are that operators in the sector are starting to adapt to mid-term labour market pressures, as well as implementing privately-run training programmes and accessing university hospitals to help alleviate skills shortages in Germany and France. At the same time many large operators are focusing on the working environment and financial incentives, to attract and retain skilled staff.

According to Stephan Caron, healthcare expert with GE Healthcare Financial Services, private sector involvement in healthcare services is seen in many countries as a critical part of solving budget problems. In the UK and Spain for instance, the focus has been on reduced waiting lists particularly for diagnostic tests and surgical operations and also in the dental sector. Meanwhile, major changes in the French and German market are driven by a shift to full DRG systems, which favour more efficient private operators. According to research from Morgan Stanley, deteriorating public hospital finances in Germany in 2008 – after the impact of budget reductions, VAT increases and 7-13% wage inflation in 2007 – are likely to accelerate privatisation decisions for standard-care public hospitals. They estimate that privatisation discussions have started for a number of university hospitals, which with around 1,500 beds each are much larger than the average German hospital (around 245 beds). Meanwhile, in the Nordic region the public sector is increasingly unable to accommodate demands driven by customer choice in the provision of healthcare and care services and as result outsourcing to experienced private providers is growing rapidly. Finally, in Italy, general dissatisfaction with the public service system's waiting lists and quality of service is likely to lead to further growth for private sector operators. In general, across Europe private domiciliary and residential care has a lower cost than in-house provision which will undoubtedly support the case for increased outsourcing.



Case Study: Gambro



In May 2007, joint MLAs GE Commercial Finance, Dresdner Kleinwort and RBS launched a credit facility to back Bridgepoint's acquisition of Gambro Healthcare from EQT for around €600 million.

How it started

EQT bought Gambro AB in 2006 for €4.2bn, and as set out in their original business plan they sought to divest Gambro Healthcare in early 2007 to focus on the two remaining businesses, Gambro Renal Products and Gambro BCT (Blood Component Technologies).

Gambro Healthcare was the dialysis services business of Gambro AB, offering end-stage renal disease treatment to approximately 12,000 patients globally in dialysis clinics across Europe, South America, Asia and Australia.

EQT was aware of GE Healthcare Financial Services' significant healthcare expertise, and so invited them to provide a staple debt financing package to all potential buyers of Gambro Healthcare. As a result, GE supported 75% of the bidders in the first round before 'treeing' in the 2nd round.

Rationale

Coming into the deal, GE had significant knowledge about the dialysis sector – not only had they been part of the debt syndicate for Gambro AB in June 2006, but they had in-depth experience from their previous equity stake in Euromedic, a leading Central and Eastern European dialysis and diagnostic imaging business. This allowed GE to obtain swift credit approval, which put them one step ahead of the other banks and allowed early access to information and management.

GE's deal team conducted a thorough due diligence, highlighting several key factors to support an investment rationale. Firstly, strong market dynamics meant that the dialysis industry was growing at 6.7% each year, attributable to an ageing population and an increasing prevalence of diabetes and obesity.

Secondly, Gambro Healthcare had a prominent position in their sector as the number two private dialysis provider in key European markets, with a diversified and stable cash flow from 155 clinics in 15 countries. Finally, customer retention rates were high due to limited alternative therapies, and the reimbursement environment was stable.

These factors created a strong case for financing an acquisition, but the process was not free from challenges. At the time leveraged loan markets were at their peak, the market was experiencing high liquidity and the time frame for full commitment was short, with just two weeks between the first and second rounds. However, GE firmly believed that the investment rationale and credit opportunity were strong, which ultimately led to their successfully supporting the Bridgepoint leveraged buyout of Gambro Healthcare in May 2007.

Execution

Bridgepoint acquired Gambro Healthcare for around €600m, and joint MLAs GE, Dresdner Kleinwort and RBS provided debt facilities worth SEK 5.15bn, which comprised senior SEK 2.7bn, SEK 0.5bn second lien and SEK 0.9bn mezzanine. In addition there was a SEK 1bn revolving credit facility.

In January 2008, Bridgepoint renamed the company to Diaverum and appointed Dag Andersson as chief executive officer. Dag brings a wealth of experience to the role, having previously spent 14 years in various posts at Mölnlycke and been a main board director of Mölnlycke Health Care AB. During his tenure, he worked with two different private equity firms, Nordic Capital and Apax, and successfully led the rapidly growing pan-European healthcare business in a private equity ownership environment.

Diaverum has performed well since the buyout – by September 2007 the number of patients had increased by 8.4% compared with the previous year, and it had opened 16 new clinics by November, six of these in Q4. With Dag Andersson at the helm, the business is in a strong position to drive growth and consolidate its leadership position globally.

Healthcare services going private

Key transactions in 2007

As a result of the above, the European healthcare services space has attracted significant involvement from private equity buyers over the past two to three years. As Caron explains: "Private equity players have been the main driver for the consolidation in the services sector, particularly in France, the UK and the Nordic region. For example, the top three nursing home groups in Sweden are owned by private equity groups. We expect this trend to continue in 2008 in particular with mid-sized players." Another observable trend of private equity involvement in the sector is that funds pursue relatively long-term investment approaches in the healthcare services space – often involving buy and build strategies.

Many transactions in the services sector have been closed at very high multiples which were largely underpinned by increased asset backed leverage and the use of Opco-propco structures. Another common feature, in particular before the credit crunch, was the use of the concept of "proforma mature run-rate EBITDA" when selling services businesses in the residential or specialist care sector. It is a method of calculation which effectively gives value to EBITDA accretive assets (or contracts) which have either been recently acquired or recently built / opened and are not yet at full maturity. The use of such calculation relies largely on a demand/supply imbalance. A change in the overall market dynamics would impact this analysis. Caron expects vendors and investment banks to continue to employ an approach which will maximise the underlying run-rate EBITDA on which they wish to sell the business, but lenders are likely to be much more conservative on run-rate lending multiples.

The past 12 months, in particular, have seen a range of buyouts and exits brokered by financial buyers. The largest deal saw BC Partners exit from Hirslanden Holding, a Swiss operator of private clinics. The buyer was Medi-Clinic, the listed South African hospital operator. The exit announced in August was valued at CHF 2.846bn (€1.7bn), or an enterprise value of CHF3.6bn (€2.2bn). BC Partners had earlier acquired Hirslanden in November 2002.

Close behind in value terms was a buyout announced in the UK market. The deal saw Cinven win the auction to acquire 25 hospitals from British United Provident Association (BUPA), the UK health insurance provider, for a total consideration of

£1.44bn (€2.1bn) to form Spire Healthcare. Others bidders in the auction included CVC and a joint venture between Ramsay Health, Australia's private hospital operator, and Blackstone. Cinven were also involved in the year's fifth largest deal, which was the €675m management buyout of United Surgical Partners Europe (USP), the Spanish hospital operator. Led by Gabriel Masfurroll and backed by Cinven, the seller was Mercapital. USP operates 33 facilities, including 13 hospitals, 3 ASCs, one imaging centre and 16 outpatient centres mainly in Madrid and Barcelona. Cinven already owns Partnerships in Care, the specialist mental healthcare provider, which it acquired in March 2005 for £552m.

Meanwhile, the year's third largest transaction was in France in March 2007. Antonino Ligresti acquired Generale de Sante (GdS), the largest French private sector acute care operator, in a deal that valued GdS at €1.8bn. The transaction should provide GdS with a stable shareholding and help it expand its operations in the healthcare industry. This was by no means the only large deal in France in 2007. February saw the management of Medi Partenaires, another French operator of acute care hospitals, agree to acquire the company in a €600m management buyout transaction backed by LBO France and Barclays Private Equity.

Another large deal in 2007 was the €863m buyout of Alliance Medical, which arguably straddles both the medtech and healthcare services areas. The deal saw Dubai International Capital, the UAE based private equity firm, acquire Alliance Medical, the UK based outsourced radiology imaging services provider, from Bridgepoint Capital. The acquisition is in line with the DIC's strategy of building up its presence in the healthcare sector. Bridgepoint Capital had acquired Alliance Medical for a consideration of £111m in January 2001. Bridgepoint was also involved in another large deal in 2007, this time as the acquiror, when EQT carved out Gambro Healthcare, the dialysis service business, from Gambro AB (see case study on page 18). Rounding out the year's top deals were one Irish and three UK based transactions, all of them involving private equity buyers on either the buy and / or sell side.

Healthcare services going private

The Outlook for M&A in 2008

Looking forward, Caron expects M&A deals brokered by both financial and strategic buyers in healthcare services to remain strong. This is not least because the sector's underlying fundamentals ensure that operators are, to some extent, insulated from wider macro-economic concerns. According to Caron: "In the long-term care sector, particularly, there will continue to be investment opportunities, especially in smaller assets or in countries which have not yet seen massive consolidation such as Germany and Italy." Caron also believes that, "The acute care sector should continue to offer investment opportunities, especially in France and Germany." For Caron, the major external influences affecting M&A in the European healthcare services sector are three fold: budgetary (which is creating significant cost containment pressures); higher regulatory standards; and finally, the decreasing length of stay in the hospital sector and shift to outpatient treatment. As a result, the overall competitive position of smaller groups in the sector is likely to weaken, and this will create opportunities for further consolidation.

Certainly, mergermarket's deal data in 2008 would appear to agree with this prognosis. The first two months of the year have already seen a wave of deals in healthcare services in the UK. Cinven remains highly active in the space. In February 2008 it bought Classic Hospitals, the UK operator of nine facilities, from LGV Capital for £145m (€193m). A buy and build transaction, this deal followed closely on the heels of Cinven's 2007 acquisition of BUPA's hospitals.

February 2008 also saw the management of Ultralase, the UK provider of laser eye treatment, agree to acquire the company from Corporacion Dermoestetica, the listed Spanish provider of cosmetic surgery services, in a transaction backed by 3i. The deal valued the company at £174.5m (€235m). Ultralase currently operates 17 eye laser clinics across the UK and 3i's investment is expected to allow the company to continue its expansion, with four new clinic openings planned for 2008. Finally, also in February 2008, the management of Verna Group, the UK based group of healthcare companies, acquired the company from LGV Capital for an undisclosed consideration estimated to be £50m in a management buyout backed by Bank of Scotland.

Healthcare services M&A: top European deals in 2007

Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Deal Value EUR (m)
02/08/07	C	Hirslanden Holding AG	Switzerland	Medi-Clinic Luxembourg Sarl	Luxembourg	BC Partners Ltd	2,182
18/06/07	C	BUPA (25 UK based hospitals)	United Kingdom	Cinven Ltd	United Kingdom	British United Provident Association Ltd	2,130
08/03/07	P	Compagnie Generale de Sante SA (75% stake)	France	Sante Holdings Srl	Italy		1,761
05/11/07	C	Alliance Medical Ltd	United Kingdom	Dubai International Capital LLC	United Arab Emirates	Bridgepoint Capital Ltd	861
10/07/07	C	United Surgical Partners Europe SL	Spain	Cinven Ltd	United Kingdom	Mercapital SL	675
01/02/07	C	Medi Partenaires	France	Barclays Private Equity Ltd; LBO France	United Kingdom; France	Cobalt Capital; Sagard Private Equity Partners	600
07/05/07	C	Gambro Healthcare	Sweden	Bridgepoint Capital Limited	United Kingdom	Gambro AB	600 (approx)
30/07/07	C	Care Principles Ltd	United Kingdom	Three Delta LLP	United Kingdom	3i Group plc	399
09/08/07	C	Mental Health Care (UK) Limited	United Kingdom	CB Care Limited	United Kingdom		377
24/04/07	C	Mater Private Healthcare	Ireland (Republic)	CapVest Equity Partners L.P.	USA		350
30/07/07	C	Healthcare at Home Limited	United Kingdom	Hutton Collins & Company Limited	United Kingdom	Apax Partners	296

Source: mergermarket

An uneven battle in European biotech?

Based on an interview with Marcus O'Neill, Vice President of Life Science Finance for GE Healthcare Financial Services Europe

The conditions for biotech M&A could not be more primed in Europe with stock prices depressed across the board and the product pipelines of many big pharma companies still wearily thin. Whether this will materialise into actual deals remains to be seen given that much of the interest in 2007 has been directed towards the US.

A quick look at M&A deal flow shows that European biotech M&A over the last two years has been far lower compared to deal flow across the Atlantic. For example, the largest deal in the period was the €810m buy of Cambridge Antibody Trust (CAT) by AstraZeneca in 2006, this transaction being some way short of the heady US\$16bn price tag paid by AstraZeneca for US based MedImmune in 2007. By contrast, according to mergermarket data, the largest deal in Europe in 2007 was the €115m acquisition of Arrow Therapeutics by AstraZeneca (see case study on page 24). Meanwhile, the second largest biotech deal in 2007, which saw Kaupthing Bank and Noonday Asset Management, the UK hedge fund, acquire a 49% stake in Bactiguard, the Sweden based owner of the antimicrobial and biocompatible bacti-guard silver alloy coating technology, was significantly smaller at SEK 420m (€46.2m).

This dynamic may be exacerbated by European companies being less attractive to US acquirers because of the continued dollar weakness but a more endemic reason may have something to do with the relative maturity of the industry within the two markets. The level of funding available to biotech companies in the US, from seed funding to public market follow-ons, is that much greater largely due to the more experienced management teams running these businesses. As Marcus O'Neill, Vice President of Life Science Finance for GE Healthcare Financial Services Europe, says: "The US can boast some very successful biotech companies such as Amgen that have proven the potential for the sector as a whole and developed a generation of experienced

managers." This contrasts with Europe which has yet to produce a similar growth story, leading investors to complain about the lack of "having done it before" management, which in turn limits the amount of funding available to only the most high profile companies. As O'Neill argues, "European companies can produce the science but the execution to profitability has been rare."

The lack of available funding has limited the exit options for European biotech as the depressed public markets have made it difficult for companies to IPO with confidence. Those with early stage pipelines are the most vulnerable in this climate, and many VCs have shifted their investment focus to later stage companies. As O'Neill points out, the net consequence of this shift towards those already with biotech products in the clinic has been a shortening of the investment cycle as a whole. As a result, biotech companies are increasingly looking to supplement cashflows with licensing deals at much earlier stages of development.

M&A deal trends

Having said all of the above, two of the more prominent M&A deals in Europe over the last two years have been platform related. The €810m acquisition of Cambridge Antibody Technology (CAT) and the €341m purchase of Domantis by AstraZeneca and GlaxoSmithKline respectively, both in 2006 have become more typical of the type of deals big pharma have struck recently in European biotech. Wary of the fierce competition for late stage assets, many in big pharma have resorted to picking off assets at earlier stages of development to limit the downside risk of failure and the associated write downs, notwithstanding the ignominy of acquiring a late stage asset that proves to be a dud.

Both Domantis and CAT provide their respective purchasers with biological discovery capabilities that can sit alongside the more traditional small molecule approaches. In particular, AstraZeneca's follow up purchase of MedImmune in the US in 2007 has provided a means by which its CAT development engine can drive drug candidates along the necessary development and clinical regulatory path to market.



An uneven battle in European biotech?

This shift towards biologics is being driven by the headfirst dive into a product pipeline chasm that big pharma faces over the next few years. This is not least because, as mentioned elsewhere in this report, the blockbuster model that drove much of the industry's growth over the last two decades has become redundant in face of generic competition. Whereas barriers to entry in the old model may have been marketing muscle, the barriers to the new model will be technological, hence the drive towards innovative biologics. Furthermore, the lack of a regulatory pathway for generic biologics for the time being also provides a barrier to competition from generic companies. The acquisition of Sirna Therapeutics in 2006, a listed Californian biotech, by Merck along with the successful IPO of Belgium-based Ablynx in late 2007, which like Domantis focuses on second generation antibody technology, are good examples of where the market has gone against the late stage development grain.

Part of this fear about buying into late stage pipelines is that "The key concern for biotech and pharma companies is the increasing scrutiny and the time taken to obtain regulatory approval for new drugs," O'Neill pointed out, noting that the FDA only approved 27 drugs in 2007 which is incredibly low given the number of biotech and pharma companies developing drugs. This has had a knock-on effect in the financing markets. While those companies that specialise in oncology, cardiovascular (including diabetes and obesity) and CNS treatments will still be picked up by big pharma radar screens, those with undiversified portfolios and/or drugs outside niche indications or unmet medical needs will find funding more difficult, he added.

Faced with a restriction in traditional sources of financing, biotechnology in Europe has become more reliant on other hitherto less prevalent forms of funding such as venture debt, royalty financing and development finance. Private investment in public equity (PIPEs) could be another option for European biotechnology, a funding route that is used quite regularly in the US, but the restrictive pre-emption rules in Europe that govern the issuance of new shares has been a problem for this type of funding to take hold.

Looking forward, at time of writing, the IPO markets look likely to remain difficult. However, a range of mid to large sized European biotech companies have been mooted as potential sources of deal flow. According to reports, Intercell, the listed Austrian biotech company is sitting on a €2878m war-chest. Intercell has a market cap of €1.1bn. Similarly, Antisoma, the UK-listed biotech with a current market capitalisation of £128m, has revealed that it is looking to make acquisitions.

An uneven battle in European biotech?

Biotechnology M&A: top European deals in 2006 and 2007

Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Deal Value EUR (m)
15/05/06	C	Cambridge Antibody Technology Group plc (CAT)	United Kingdom	AstraZeneca plc	United Kingdom		810
07/06/06	C	NeuTec Pharma Plc	United Kingdom	Novartis AG	Switzerland		405
20/06/06	C	Biacore International AB	Sweden	General Electric Company (GE)	USA	Pfizer Health AB	352
08/12/06	C	Domantis Ltd	United Kingdom	GlaxoSmithKline plc	United Kingdom	3i Group Plc; Arana Therapeutics Limited; MVM Limited	341
19/12/06	P	Genmab A/S (10.13% stake)	Denmark	Glaxo Group Limited	United Kingdom		273
01/02/07	C	Arrow Therapeutics Ltd	United Kingdom	AstraZeneca plc	United Kingdom	3i Group Plc; Alta Partners; Atlas Venture; GIMV; Merlin Biomed Group; NIF SMBC Ventures Co Ltd; NVM Private Equity Limited; TVM Techno Ventures Management	115
17/05/06	C	CropDesign NV	Belgium	BASF AG	Germany	KBC Private Equity NV	100
04/10/06	C	Biotrace International plc	United Kingdom	3M Company	USA		83
09/01/06	C	Micronet, Inc.	Germany, USA	CancerVax Corporation	USA		71
20/06/06	P	Ideon AB	Sweden	Wihlborgs Fastigheter AB	Sweden		71
31/01/06	C	Nabriva Therapeutics Forschungs GmbH	Austria	Global Life Science Ventures; HBM BioVentures AG; Nomura Private Equity; Novartis Venture Fund; Wellcome Trust Ltd	Germany; Switzerland; United Kingdom; Switzerland; United Kingdom	Sandoz International GmbH	42
15/01/07	C	Bactiguard AB (49.00% stake)	Sweden	Kaupthing Bank Sverige AB; Noonday Asset Management LLP	Sweden; United Kingdom		36

Source: mergermarket

Case Study: Arrow Therapeutics

GE Healthcare Financial Services, a division of GE Commercial Finance, provided a £4m term loan facility to Arrow Therapeutics, a UK privately-held company dedicated to the discovery of novel drugs for anti-infective therapies.

How it started

In 2006, Atlas Venture suggested that GE Healthcare Financial Services meet the management team of one of their key biotech investments, Arrow Therapeutics, to explore the options for injecting some venture debt into the business. As one of the largest venture capitalists in Europe, Atlas Venture has built a reputation for investing in high-potential biotech companies and had a significant stake in Arrow, a UK biopharmaceutical company specialising in viral therapeutics.

Arrow had raised funding in a Series B equity round the previous year, which was tranchised into three separate draw-downs. By the time GE got involved, Arrow had drawn down the first two tranches and was deliberating over when to draw down the third. Its investors (Atlas and other top-tier VCs) were starting to think about exit opportunities but needed more time to determine the best strategy.

The rationale

After discussions with GE about using venture debt as a means to strengthen their balance sheet, Arrow and Atlas concluded that rather than draw on the 3rd tranche at the time of an intended IPO, they should draw on it immediately and leverage this liquidity to secure additional financing in the form of venture debt. This would allow them to extend their cash runway from 12 to 18 months in preparation for the IPO, without diluting their existing equity holders. The liquidity gained from the equity injection made the risk profile more attractive to GE as lenders.

The execution

So in May 2006, Atlas invested £4m of equity and GE provided £4m of debt, using Arrow's intellectual property and other assets as a form of security. As part of the transaction GE was also granted a small number of warrants in the company. The deal was completed within just seven weeks of signing the term sheet, and the £8m injection of capital afforded Arrow more time to seek the best terms for their eventual exit. Arrow used the loan proceeds for general working capital; to fund ongoing research and development into viral therapies for RSV (respiratory-synctial virus) and Hepatitis C; and to finance new equipment. At the time, the CEO of Arrow, Ken Powell, commented that "the GE term loan is ideal for our short- to medium-term financing needs during a time when our business is progressing rapidly."

Result

Ultimately the company did not proceed to an IPO, but was acquired by AstraZeneca in February 2007, and shareholders enjoyed a materially higher level of return as a result of having used debt alongside equity. The transaction was GE's first venture debt deal in Europe and proved the value of the product by granting Arrow the time and cash runway to choose the right exit strategy without diluting their shareholders, whilst allowing GE to convert their warrants and earn some upside on the deal. It also showed how equity and debt can be blended to effectively lower the cost of capital and maximise the efficiency of the balance sheet for cash-burning biotech companies.

Although venture debt is widely used in the US it is still relatively new to Europe, especially in the biotech sector, and so this deal has attracted significant interest in the industry. The increased awareness of the product is now paving the way for other companies to leverage the value of their intellectual property and use debt effectively to strengthen their balance sheet.

European Healthcare M&A Historical Data

Top European Healthcare deals 2007

Number	Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Seller Country	Deal Value EUR (m)
1	12/03/07	C	Organon BioSciences NV	Netherlands	Schering Plough Corporation	USA	Akzo Nobel NV	Netherlands	11,000
2	12/05/07	C	Merck Generics	Germany	Mylan Laboratories Inc	USA	Merck KGaA	Germany	4,900
3	1/06/07	C	Actavis Group hf (61.5% stake)	Iceland	Novator Partners LLP	United Kingdom			3,465
4	26/01/07	C	Molnlycke Health Care AB	Sweden	Investor AB; Morgan Stanley Principal Investments	Sweden; USA	Apax Partners	United Kingdom	2,850
5	02/08/07	C	Hirslanden Holding AG	Switzerland	Medi-Clinic Luxembourg Sarl	Luxembourg	BC Partners Ltd	United Kingdom	2,182
6	18/06/07	C	BUPA (25 UK based hospitals)	United Kingdom	Cinven Ltd	United Kingdom	British United Provident Association Ltd	United Kingdom	2,130
7	08/03/07	P	Compagnie Generale de Sante SA (75% stake)	France	Sante Holdings Srl	Italy			1,761
8	19/11/07	C	Gyrus Group plc	United Kingdom	Olympus Corporation	Japan			1,435
9	15/11/07	P	Polpharma SA (99.65% stake)	Poland	Gedeon Richter NyRt	Hungary	Genefar BV	Netherlands	886
10	05/11/07	C	Alliance Medical Ltd	United Kingdom	Dubai International Capital LLC	United Arab Emirates	Bridgepoint Capital Ltd	United Kingdom	861
11	09/02/07	C	UCB SA (7.58% stake)	Belgium	Financiere de Tubize	Belgium	Schwarz Vermögensverwaltung GmbH & Co KG	Germany	677
12	10/07/07	C	United Surgical Partners Europe SL	Spain	Cinven Ltd	United Kingdom	Mercapital SL	Spain	675
13	12/03/07	C	Plus Orthopedics Holding AG	Switzerland	Smith & Nephew plc	United Kingdom			671
14	03/12/07	P	Bruker BioSpin Inc; Bruker Biospin Invest AG; Bruker Physik GmbH	USA; Switzerland; Germany	Bruker BioSciences Corporation	USA			625
15	13/06/07	C	Madaus Pharma	Germany	Rottapharm Spa	Italy	Droege International Group AG; Madaus Family	Germany	600

Source: mergermarket

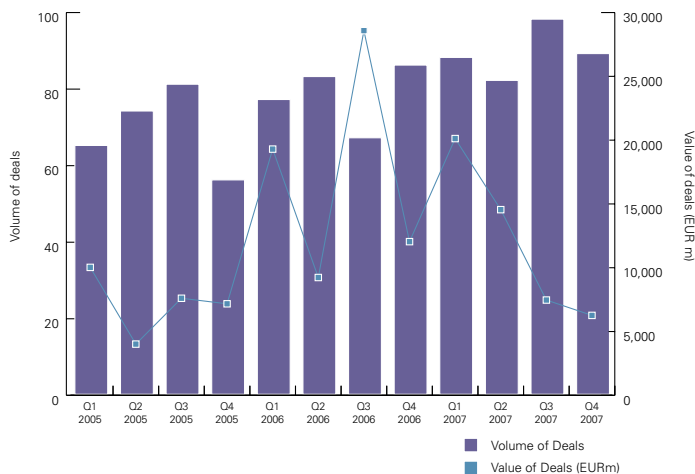
Historical Data

Top European Healthcare deals 2007 Contd.

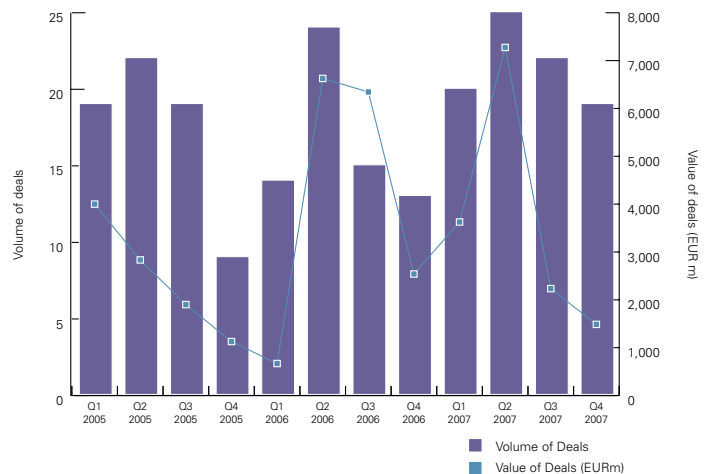
Number	Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Seller Country	Deal Value EUR (m)
16	01/02/07	C	Medi Partenaires	France	Barclays Private Equity Ltd; LBO France	United Kingdom; France	Cobalt Capital; Sagard Private Equity Partners	France	600
17	05/03/07	C	Eczacibasi Ozgun Kimyasal Urunler Sanayi ve Ticaret AS (75% stake); Eczacibasi Saglik Urunleri Sanayi ve Ticaret AS (75% stake)	Turkey	Zentiva NV	Czech Republic	EIS Eczacibasi Ilac Sanayi ve Ticaret AS	Turkey	460
18	16/04/07	C	Sante Luxembourg (43.01% stake)	France	DeA Capital Spa	Italy	Sante Holdings Srl	Italy	405
19	30/7/07	C	Care Principles Ltd	United Kingdom	Three Delta LLP	United Kingdom	3i Group plc	United Kingdom	399
20	16/7/07	C	Hermal	Germany	Almirall-Prodesfarma SA	Spain	Reckitt Benckiser plc	United Kingdom	377

Source: mergermarket

European Healthcare M&A trends

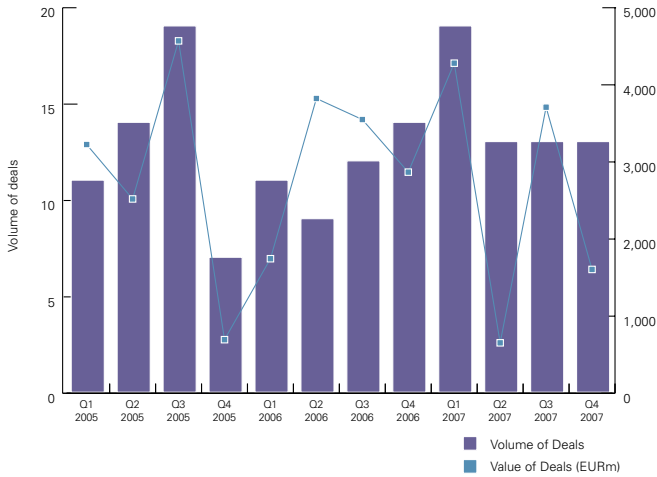


European Healthcare buyout trends

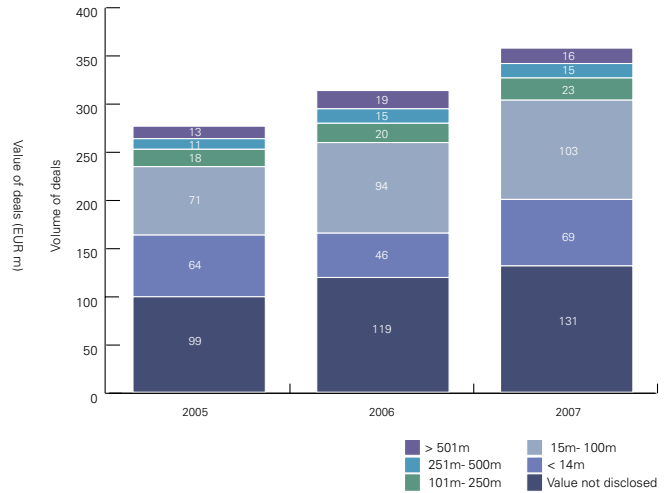


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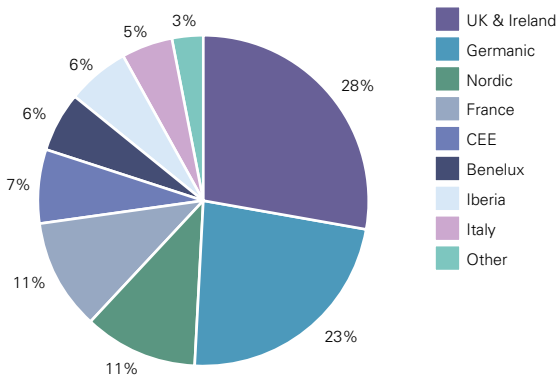
European Healthcare exit trends



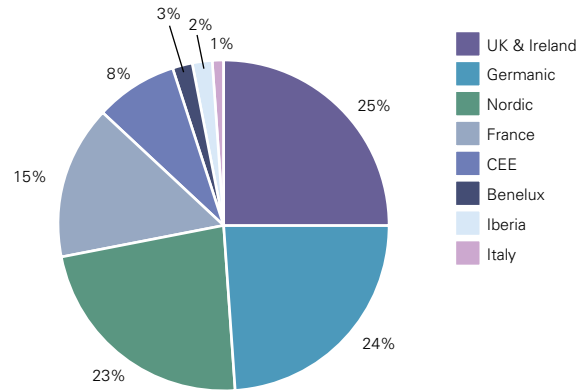
Deal size split of European Healthcare M&A – volume



Geographic split of European Healthcare M&A 2007 – volume



Deal size split of European Healthcare M&A – value



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