Global Capital Confidence Barometer

June 2018 | 18th edition | Health highlights

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Is your portfolio fit for the future or fashioned on the past?

Businesses are reshaping for a better tomorrow through portfolio transformation

The better the question. The better the answer.
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Industry disruption, combined with relentless pressure to reduce costs, is **increasing M&A appetites** across the sector.

48%

intend to pursue M&A in the next 12 months.

As health organizations look to future-proof their businesses, **portfolio transformation** is becoming a top priority.

64%

say portfolio transformation is the top priority on the boardroom agenda.

Health organizations are looking to **divest assets** as they shape their portfolios of the future.

76%

have identified underperforming assets or those at risk of disruption to divest.

Despite **emerging challenges** ...

49%

see rising inflation as the dominant risk to their current investment plans; 37% cite market volatility.

... **executives remain confident** about the conditions for dealmaking ...

60%

expect M&A in the health sector to improve in the next 12 months.

... even as they anticipate **increasing competition** for assets, particularly from **private equity**, which is set to deploy record dry powder in the hunt for high-quality assets.

67%

expect increased competition for assets in the coming year; 79% say private equity will be their fiercest competitors.

Contents

Is your portfolio fit for the future or fashioned on the past?

As we expected, the results of the latest *Capital Confidence Barometer* reflect a sector grappling with massive and rapid transformation. Exponential advances in digital technologies, sector convergence and fierce competition are propelling health organizations to rethink their strategies.

M&A appetites have increased significantly from a year ago, as dealmaking intentions shift from "wait and watch" to "act now." Almost half of our respondents intend to pursue deals in the coming year, with 60% believing temperatures in the M&A market in their sector will continue to rise. A steep recovery in the M&A pipeline and in deal completions underpin these intentions as organizations become more aggressive in their pursuit of high-quality assets. Yet, even as the M&A market accelerates, executives are holding firm on dealmaking discipline, with 78% saying they have failed to complete a planned deal in the last 12 months.

A hotter M&A market can, at least in part, be attributed to portfolio transformation, as health organizations focus on rightsizing their portfolios. Almost two-thirds of health executives say that portfolio transformation has risen to the top of the boardroom agenda. Shareholder activism is also top of mind. In an effort to shape portfolios of the future, both boards and activist shareholders are centering their attention on asset disposal. However, their reasons appear to differ. While executives may lean more toward recycling capital into the portfolio, activists are looking to see a certain element of realized capital be returned to shareholders.

We are also seeing the re-emergence of private equity as a major player in the industry. The recent M&A cycle has been dominated by corporate acquirers. However, private equity rebounded in 2017 and is set to take a more aggressive role in competition for assets. The challenge for private equity will be to find companies with the necessary infrastructure to support growth and with management teams sophisticated enough to build scalable, sustainable enterprises.

As we look ahead, health executives say they expect cross-border dealmaking to be the predominant theme of M&A in the next 12 months. This is despite the geopolitical uncertainty that serves as a dominant hurdle to near-term growth.

W. Gregg Slager
EY Global Health Transaction Leader

Macroeconomic outlook and external environment

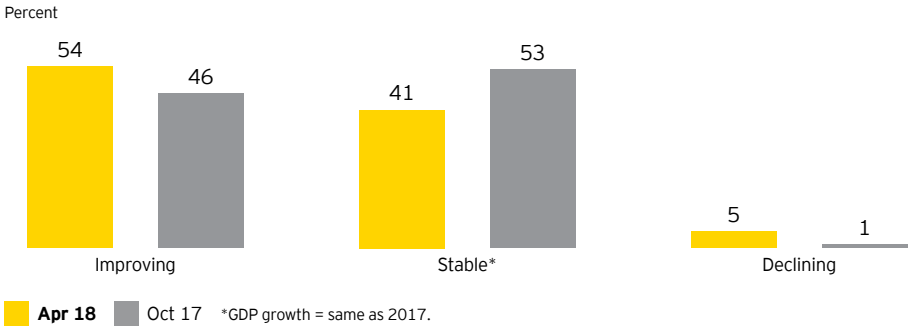
Broad-based synchronized growth underpins a favorable economic outlook, but there could be headwinds as geopolitical tensions flair

Q What is your perspective on the state of your sector economy today?

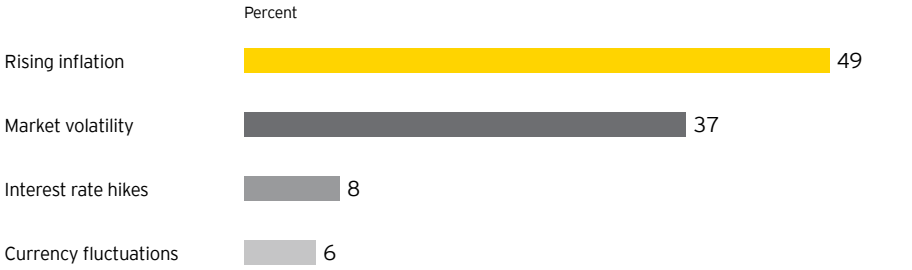
Improving global growth is set to provide a boost to organic operations, and increase the expectations of investors.

Within the sector, health executives are feeling positive, a welcome sight in an industry experiencing ongoing disruption. Opportunities arising from consumerism, demographic changes, increased demand in international markets and health delivery transformation contribute to this optimism.

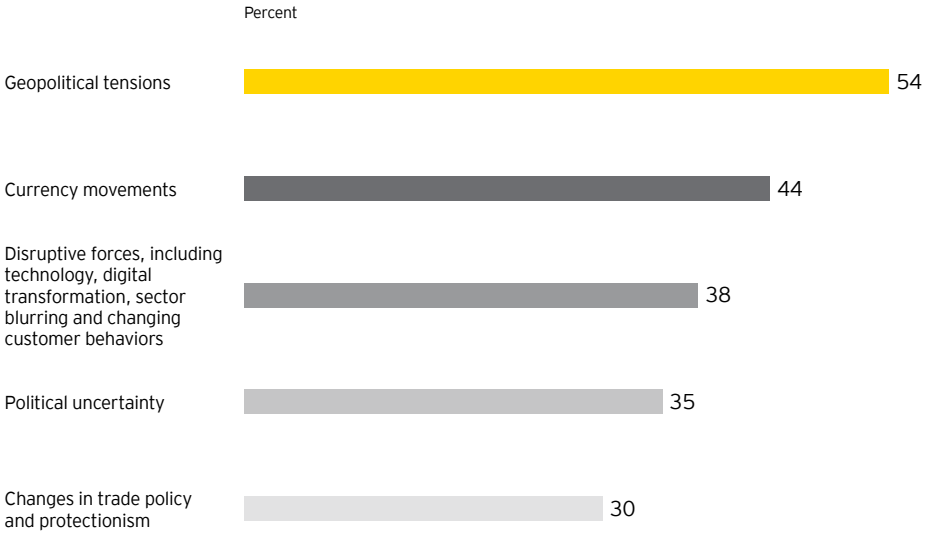
Despite the confidence, health executives cite rising inflation and market volatility as key risks to their investment plans, while geopolitical tensions and fluctuating currency exchange rates have the potential to hamper near-term growth.



Q What is the bigger risk to your current investment plans?



Q What do you believe to be the greatest near-term risk to the growth of your business?*



*Respondents were able to select up to three options. Only the top five risks are displayed, and results reflect the percentage that chose each risk.

Boardroom agenda and shareholder activism

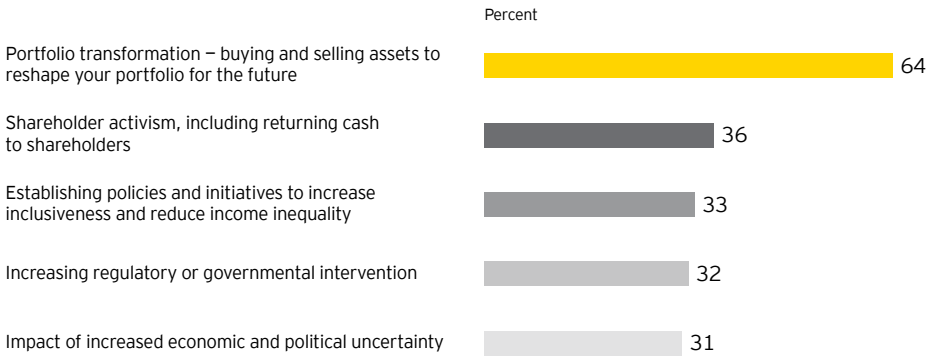
Health organizations are looking for a strategic plan that will help them to future-proof their businesses

To increase profit margins and remain relevant in today's disruptive environment, health organizations are looking to rightsize their portfolios.

Almost two-thirds of health executives say that portfolio transformation has risen to the top of the boardroom agenda. As health organizations feel disruption from all sides, 42% indicate that they are reviewing their portfolios every six months or more, with digital disruption leading the charge.

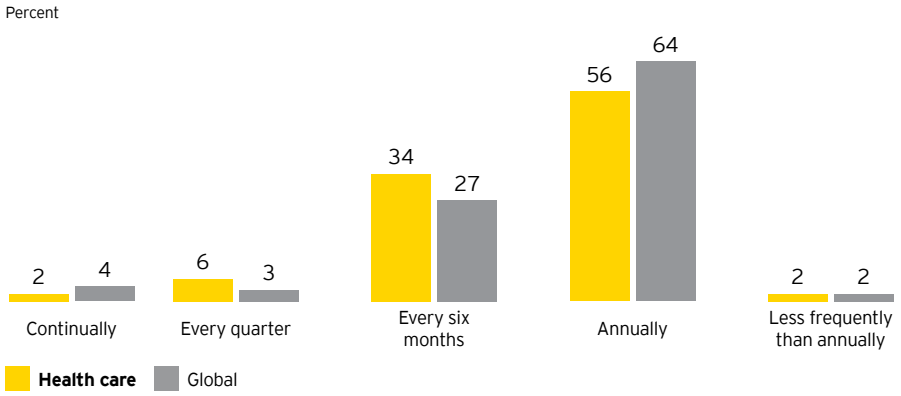
Health executives attribute the increasing frequency to threats from digitally enabled competitors and start-ups, the impact of digital technology and transformation to the business, and increased competition from other sectors, such as technology.

Q Which of the following will be most prominent on your boardroom thinking during the next six months?*

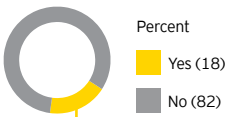


*Respondents were able to select up to three options. Only the top five risks are displayed and results reflect the percentage that chose each risk.

Q How frequently are you reviewing your portfolio?



Q Is this more frequent than three years ago?



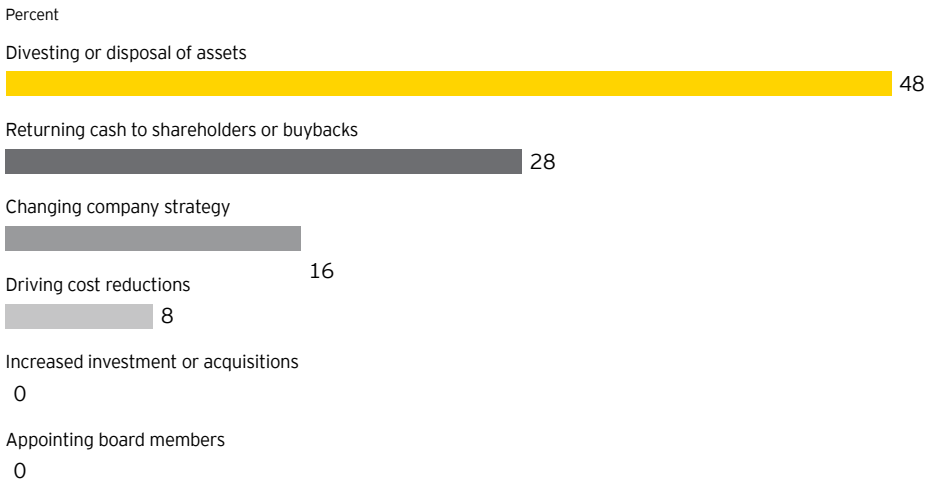
Q If yes, what is the key reason for reviewing your portfolio more frequently?

Portfolio transformation and shareholder activism are driving divestment

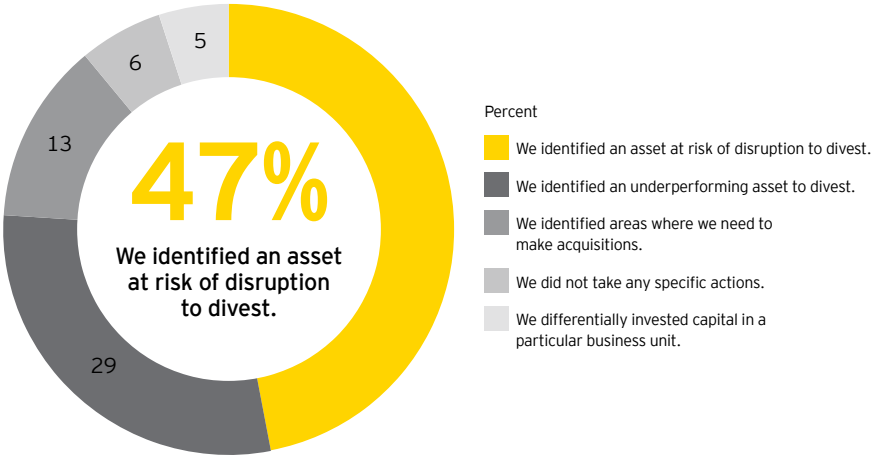
Q On what do you expect shareholder activists to focus their influence in the next 12 months?

To shape portfolios of the future, both boards and activist shareholders are centering their attention on asset disposal.

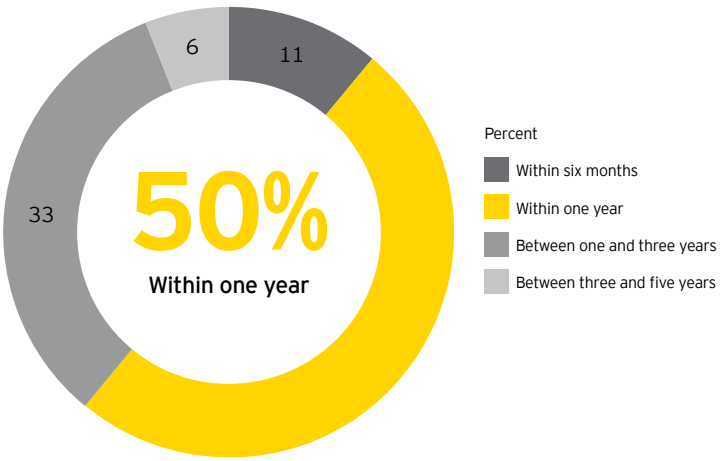
As a result of their most recent portfolio review, three-quarters (76%) of health executives say they have identified underperforming assets or those at risk of disruption to divest; two-thirds say they will be seeking to dispose of these assets within the next year or sooner.



Q As a result of your most recent portfolio review, what was the main action taken?



Q Following your most recent portfolio review, over what time frame did you achieve, or do you expect to achieve, your objectives?

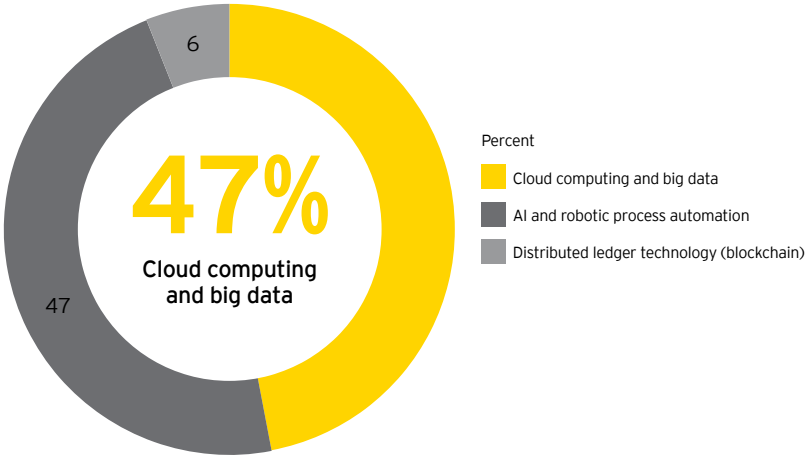


As the health industry marches toward a digital future, consumerism is a central objective

Q Which of the following technologies are most prominent on your boardroom agenda?

Feeling the squeeze from digitally native companies and start-ups within and outside the industry, health organizations look to prioritize the use of digital technologies to improve performance.

Cloud, big data, artificial intelligence (AI) and robotic process automation (RPA) have become prominent technologies for health organizations. They are analyzing patient-related health and medical data they've amassed to reach a deeper understanding of outcomes. However, even as they continue to collect petabytes of patient data, health organizations should prepare to see an increase in data protection laws, such as General Data Protection Regulation (GDPR) in Europe, to protect data privacy and transfer.

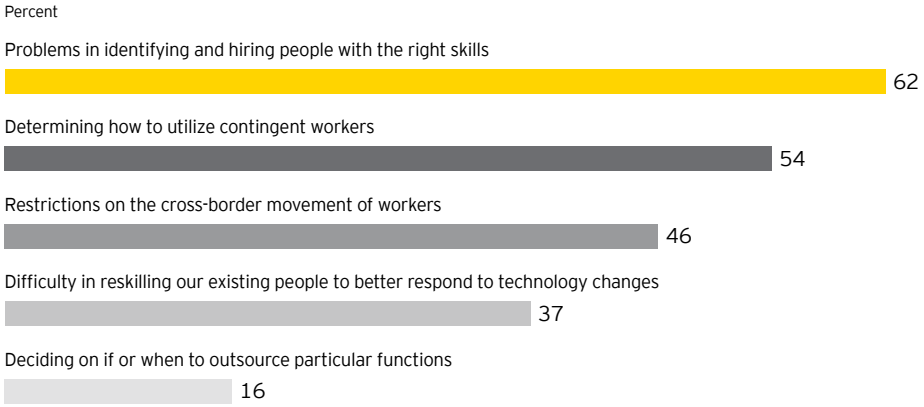


Tomorrow's health economy will demand new skills and the right mix of talent

Q Which of the following workforce issues is your organization encountering?*

As health organizations look ahead, one of the biggest challenges they face is in finding the optimal workforce balance.

Tomorrow's health economy and business models demand the right mix of human capital. For almost two-thirds (62%) of health executives, the biggest challenge is identifying and hiring people with the right skills to work in today's complex health organizations. This may explain why more than half are trying to figure out how best to use contingent workers. However, this approach brings its own complexities. Organizations need to be mindful about the hidden costs, potential regulatory issues and the impact on the organization's culture.



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M&A outlook

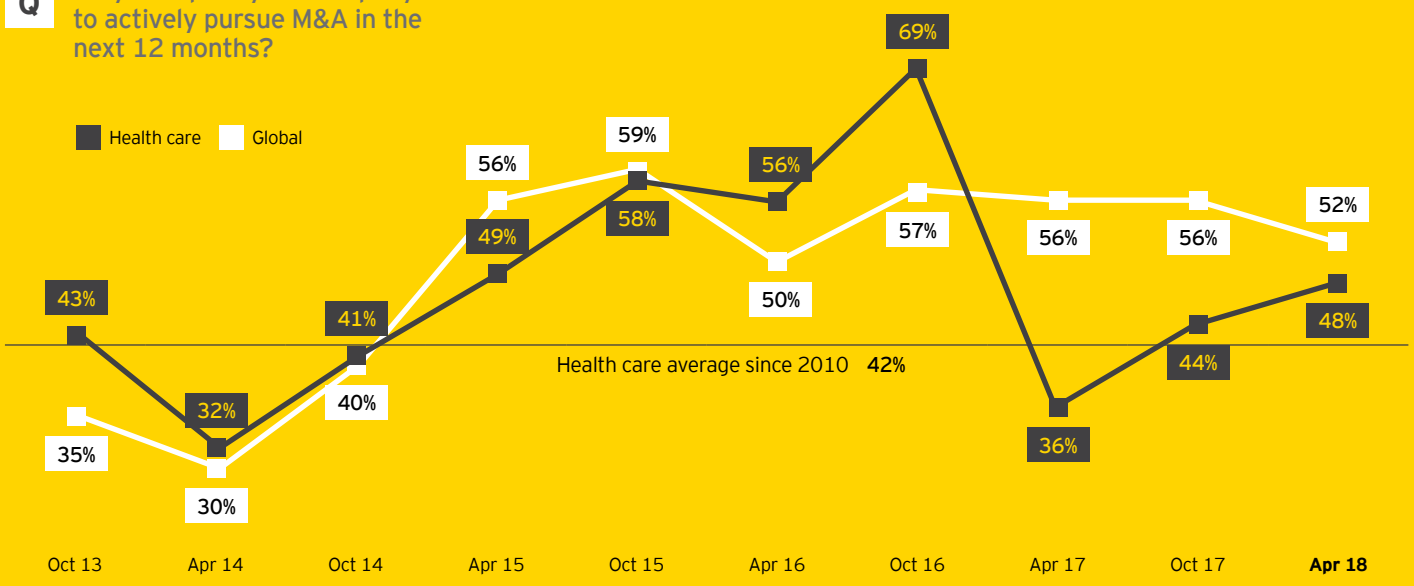
Healthy M&A is set to continue as dealmaking intentions shift from "wait and watch" to "act now"

Exponential advances in digital technologies, sector convergence and fierce competition are increasing M&A appetite within the health sector.

Nearly half (48%) of the health executives we surveyed say they expect to pursue M&A in the next 12 months, an increase of 12 percentage points from the same time last year. This confidence follows a record first quarter of global dealmaking in 2018. Reasons for the upswing in M&A activity include a wave of vertical integrations as health organizations aim to reduce costs through efficiencies and eliminate redundancies in the health supply chain. Recent consolidations may also be a defensive move against the entrance of nontraditional players in the industry, particularly technology giants.

Q Do you expect your company to actively pursue M&A in the next 12 months?

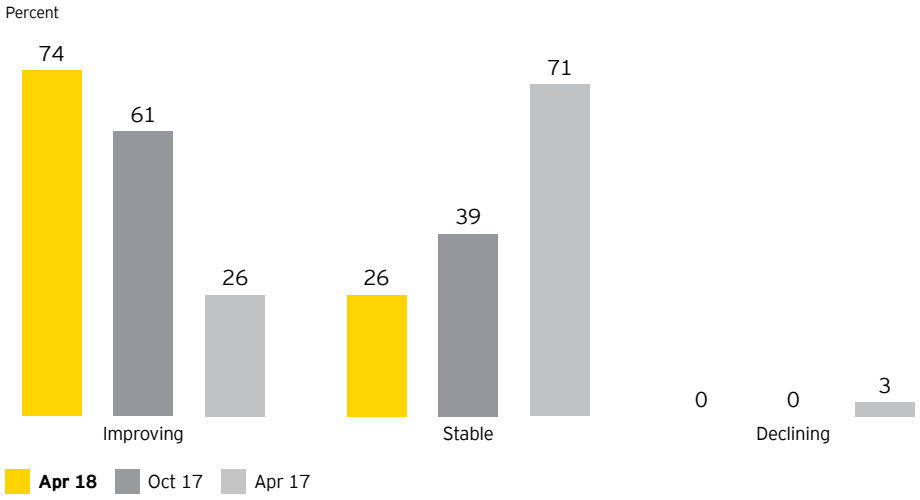
Expectations to pursue an acquisition



It's a trend that 61% of health respondents expect will improve in the year ahead within their market.

Confidence stems from a healthy macroeconomic outlook, as well as a record first quarter of global dealmaking in 2018. US tax reform and a better macroeconomic environment in Europe have also raised investor confidence.

Q What is your expectation for the global M&A market in the next 12 months?



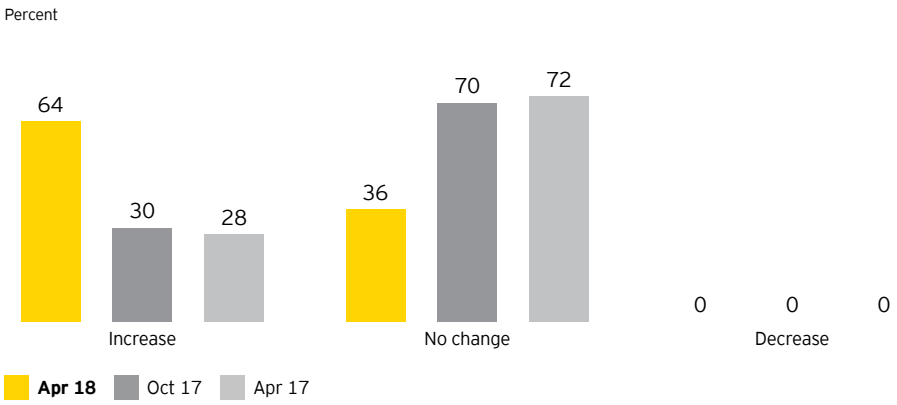
Health industry sees a steep recovery in pipelines and deal completions

An increasing M&A pipeline indicates another positive sign for future dealmaking.

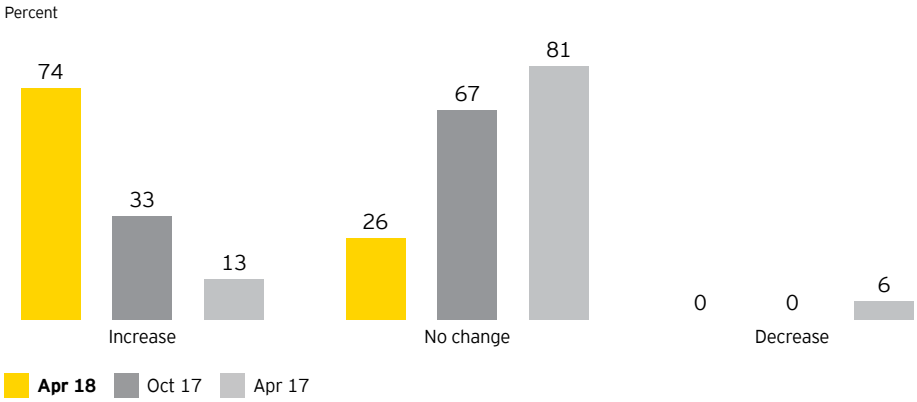
Pipeline growth has gained a remarkable boost in 2018, with 64% saying they expect an increase in their pipelines, up 34 percentage points from six months ago.

At the same time, as health companies get better at targeting assets and using analytics as part of their due diligence, three-quarters of executives feel more confident about completing the deals they are pursuing.

Q Considering the next 12 months, how do you expect your M&A pipeline to change?



Q Considering the next 12 months, what is your expectation for the number of deal completions by your company compared with the past 12 months?



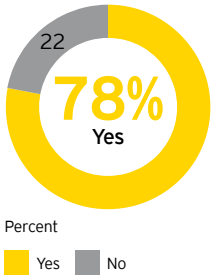
Private equity is set to deploy record dry powder as the hunt for high-quality assets heats up

As we head into the second half of 2018, health executives expect a fight for assets.

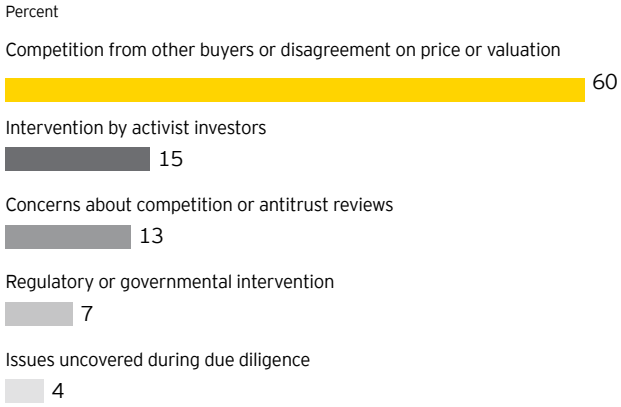
While corporate acquirers have dominated the current M&A cycle, the resurgence of private equity in 2017 has two-thirds of health executives expecting stiff competition in the next 12 months, predominantly from private equity players.

With business transformation and effective negotiations being the key deliverables sought after, private equity firms seem to be more aggressive in deals compared with other strategic investors. However, the challenge for them will be to find companies with the necessary infrastructure to support growth and with management teams sophisticated enough to build scalable, sustainable enterprises.

Q Have you either failed to complete or canceled a planned acquisition in the past 12 months?



Q If yes, what was the primary reason?



Top investment destinations

Top investment destinations are moving to developed economies, leaving China out of the top five

Interestingly, Canada has risen to become the top investment destination, as investors eye the country as a hot destination for medical tourism. At number two, the UK has re-emerged as a top destination as investors gain confidence around GDPR and increasing clarity around Brexit. The US remains among the top five, but has lost its position as the investment destination of choice as new entrants pour in, hampering sustained growth in the US market.

Top five investment destinations

1  Canada

2  UK

3  US

4  Australia

5  Brazil

> The US remains among the top five, but has lost its position as the investment destination of choice as new entrants pour in, hampering sustained growth in the US market.

Contact

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About the survey

The *Global Capital Confidence Barometer* gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their EY Capital Agenda framework for strategically managing capital. It is a regular survey of senior executives from large companies around the world, conducted by Euromoney Institutional Investor Thought Leadership (EIITL). Our panel comprises select global EY clients and contacts, and regular EIITL contributors.

- In March and April, we surveyed a panel of over 2,500 executives in 43 countries; 64% were CEOs, CFOs and other C-level executives.
- Respondents represented 14 sectors, including financial services, consumer products and retail, technology, life sciences, automotive and transportation, oil and gas, power and utilities, mining and metals, industrials, and real estate, hospitality and construction.
- Surveyed companies' annual global revenues were as follows: less than US$500m (25%); US$500m–US$999.9m (25%); US$1b–US$2.9b (20%); US$3b–US$4.9b (8%); and more than US$5b (22%).
- Global company ownership was as follows: publicly listed (58%), privately owned (35%), family owned (4%) and government or state owned (3%).

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