December 2018 | 19th edition | ey.com/CCB

Global Capital Confidence Barometer

Health highlights

In an age of M&A complexity, do you pause or proceed?

Regulation, trade and tariffs foster a deal hiatus for some, while many others move forward with acquisition plans.

The better the question. The better the answer. The better the world works.

EY
Building a better working world

44%

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

Health executives remain **optimistic about the future growth** of the health sector …

34%

highlight disruptive forces as the top near-term risk to growth in the health sector.

… but **disruptive forces** could pose near-term risks to growth.

50%

see regulation and political uncertainty as the biggest risk to dealmaking in the next 12 months.

Meanwhile, **regulatory intervention**, identified as the top risk to M&A activity in the next year …

26%

cite regulatory intervention as the top reason a planned acquisition failed.

… is also the top reason health executives cite for **failed acquisitions**.

61%

are reviewing their portfolios at least every six months.

As a result, health organizations are **reviewing their portfolios** more regularly …

39%

have identified assets at risk of disruption to divest.

… and **identifying assets that are ripe for divestment**, either because they are underperforming or at risk for disruption.

2 Macroeconomic environment
5 M&A outlook
8 Top investment destinations
3 Corporate strategy and portfolio transformation
7 Integration and synergies

In an age of M&A complexity, do you pause or proceed?

The health industry has historically been largely unaffected by the transformative impacts of technology. Not so anymore. The pace and pervasiveness of digital disruption — combined with a rush of nontraditional players entering the market — is threatening growth across the sector. In response, we're seeing health organizations turn to dealmaking to pursue opportunities in new markets, while shedding assets at risk of disruption.

With pipelines stable, expectations for M&A continue to remain strong, as 44% of health organizations expect to pursue mergers and acquisitions in the next 12 months. Health executives say seeking an integrated solution and moving beyond their comfort zone are their primary considerations for dealmaking. This aligns with a global trend toward rising incomes in developing markets, and an increase in universal coverage. The fastest way to access these markets is through acquisition. Meanwhile, the streamlined, convenient experiences consumers have in other sectors, such as online banking and retail, have them demanding more from their health care. As a result, health organizations are looking for targets that help them to adopt a more customer-centric business model.

On the flip side, health organizations are using regular portfolio reviews to continually assess their strategic priorities and address investor demands to balance investments with the capital available to finance them. For 71% of executives, these reviews have identified assets ripe for divestment, either because they are underperforming or because they are at risk of disruption.

To maximize the synergies of their acquisitions, 43% of health organizations say they are starting the integration process earlier in the deal life cycle. Our findings suggest, however, that they still have work to do, as more than half of health executives admit having achieved lower synergies than those identified.

As we look ahead to 2019, it appears as if private equity will be the big story. More than one-third of health organizations see private equity increasing their activity in the sector, particularly in the home health and behavioral health segments. More than half say they will increase the competition for assets.

Overall, after recent strong quarters of dealmaking, we expect a continued steady pace in the year ahead.

W. Gregg Slager
EY Global Health Transaction Leader

Macroeconomic environment

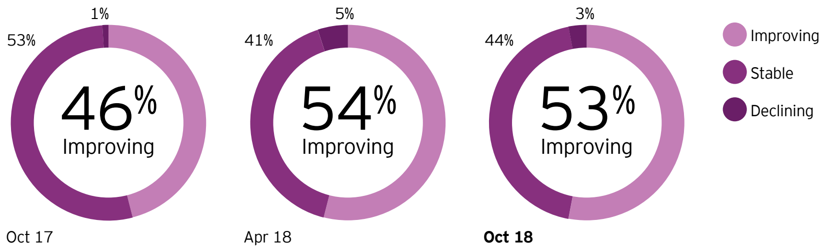
Health executives remain optimistic about the future growth of the health sector, but disruptive forces could pose near-term risks

Macroeconomic fundamentals buoy optimism in a sector poised for growth.

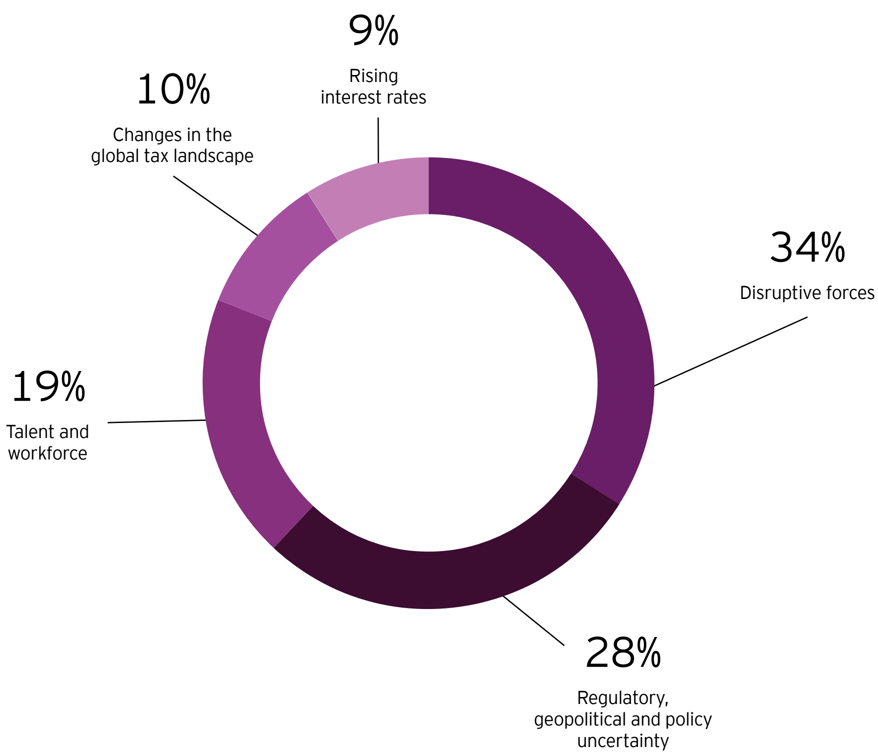
Rapidly aging populations, an increase in lifestyle-related diseases, the rise of middle class and super consumers, and the implementation of universal health coverage in emerging countries are driving changes that position the sector for growth, even as it continues to undergo rapid transformation. More than half of health executives see an improvement in the sector economy. Their improving confidence in global corporate earnings, short-term market stability and equity valuations further bolster the reason for their optimism.

However, although the health industry historically has remained relatively unaffected by the transformative impacts of technology (shielded partly by regulation), the pace and ubiquity of the disruption is increasing. At the same time, nontraditional players are entering the health industry. These disruptive forces – technology, digital, sector blurring, changing customer behavior and competition from nontraditional players – create growing concern for more than a third of health executives, who see them as the most recognized near-term risk to growth.

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



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



Corporate strategy and portfolio transformation

Uncertainty in the market has health organizations reviewing their portfolios more regularly

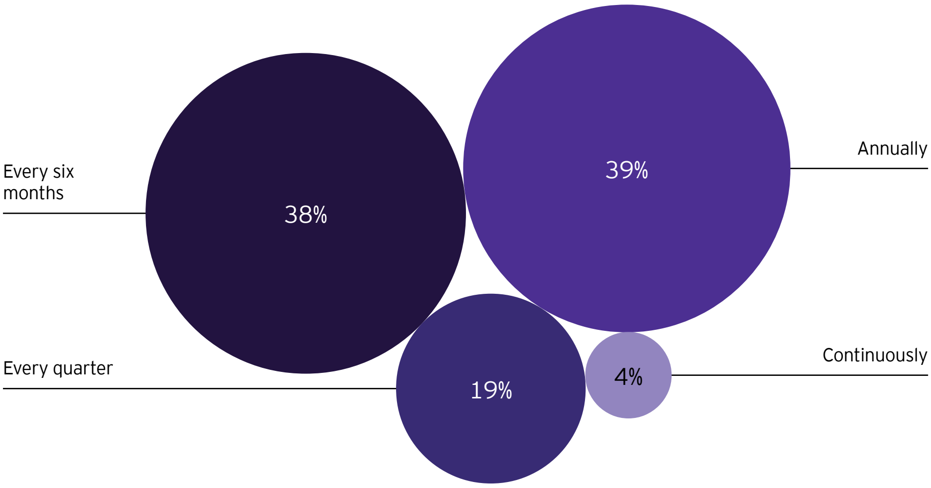
As financial pressures increase, health organizations look to balance liquidity with investment in existing operations.

Uncertainty about the global economy and financial markets is increasing pressure on health organizations. Investors are demanding health companies actively manage their business portfolios and balance investments against the capital available to finance them.

Thirty-three percent of executives indicate that improving working capital management is the primary driver of their capital allocation strategy; 25% suggest that their attention is centered on investing in existing operations.

Continuous change in the business environment, largely from technology disruption and policy uncertainty, is also leading health organizations to frequently revisit their portfolios, as well as their financial and investment strategies, so that they can keep risk levels in check. More than 60% of health executives surveyed say that they review their portfolios at least every six months; 54% say they review their financial and investment strategy with the same frequency.

Q How frequently are you reviewing your portfolio?

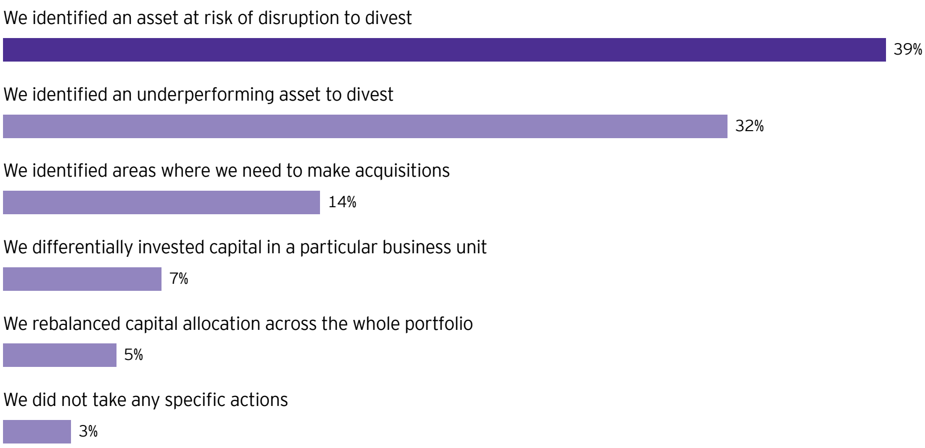


Health executives are using portfolio reviews to maintain both top- and bottom-line growth

Portfolio reviews identify assets ripe for divestment.

Nearly 40% of health executives say they are looking to divest assets at risk of being negatively affected by disruption in technology and digital innovation; 32% report finding underperforming assets to divest in an attempt to improve their financial position.

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



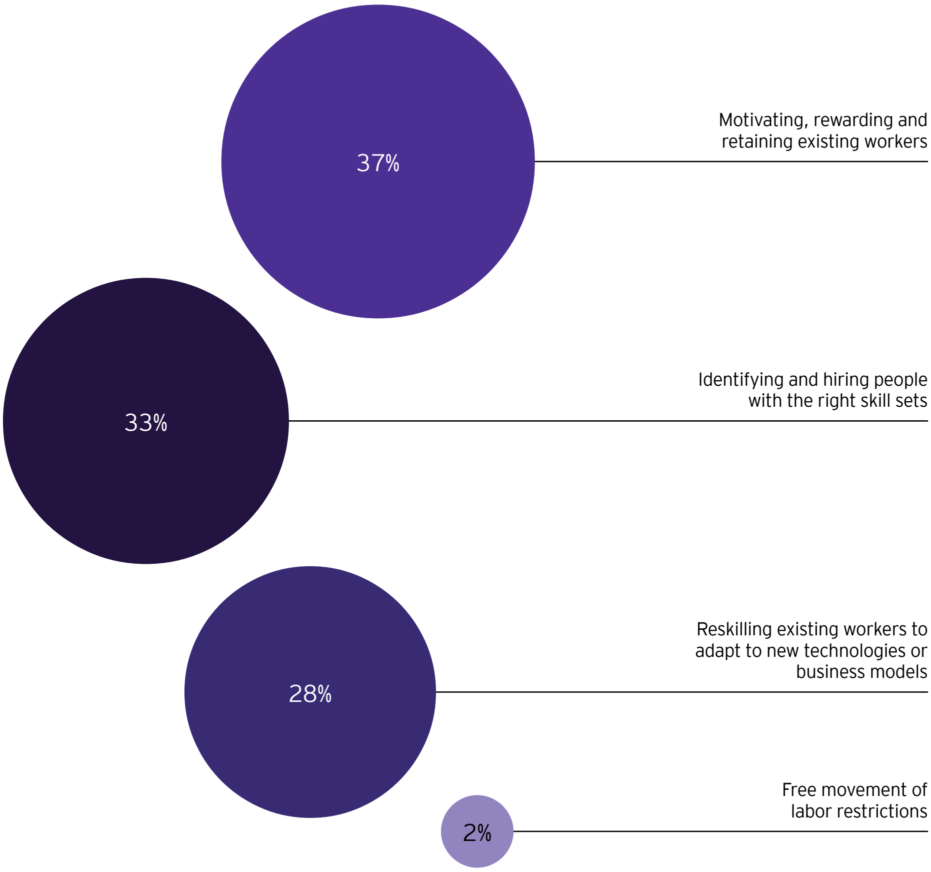
Workforce shortage has health organizations looking to motivate and retain existing employees

The challenge shifts from finding the optimal workforce balance to keeping their workforce happy.

The health care workforce shortage is worsening globally. According to research by Mercer, the US will need to hire 2.3 million new health care workers by 2025 to adequately take care of its aging population. Furthermore, physician burnout is now a recognized global issue.

As a result, health executives are shifting their attention from finding the optimal workforce balance to engaging and retaining the workers that they have. Thirty-seven percent say that motivating, rewarding and retaining existing workers is their top challenge. Meanwhile, 33% continue to struggle with identifying and hiring people with the right skills.

Q What is your most significant workforce challenge?



The health care workforce shortage is worsening globally. According to research by Mercer, the US will need to hire 2.3 million new health care workers by 2025 to adequately take care of its aging population.

M&A outlook

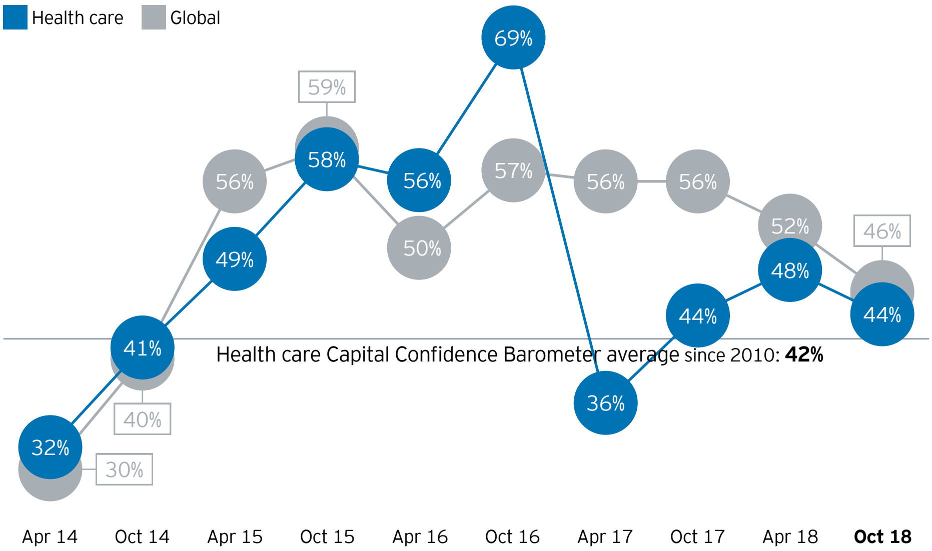
M&A expectations remain strong

A stable pipeline fuels expectation for M&A.

Although deal intentions have dipped slightly from six months ago (44% today versus 48% six months ago), a stable pipeline has a majority (60%) of health executives seeing M&A prospects in the sector improving over the next 12 months.

According to data from Thomson Reuters, the value of deals in the health sector doubled in the first half of 2018, reaching US$315.7 billion. Overall, the health sector ranks third behind energy, and media and entertainment in terms of total deal volume.

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

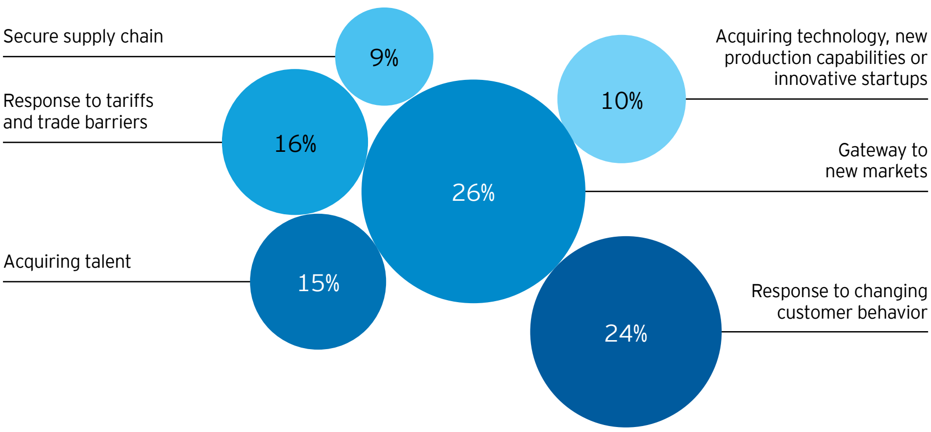


Health organizations are looking to enter new markets to seek an integrated solution and in response to changing customer behavior.

Similar to results from our last survey, a few organizations intend to pursue M&A to increase their market domination. However, a larger number are seeking an integrated solution, moving beyond their comfort zone and niche – 26% say they are looking to access new markets, while 24% indicate they are reacting to changes in customer behavior.

These results align with a global trend toward rising incomes in developing markets, combined with an increase in universal coverage. The fastest way to access these markets is through acquisition. Meanwhile, the streamlined, convenient experiences consumers have in other sectors, such as online banking and retail, has them demanding more from their health care. As a result, health organizations are looking for targets that help them to adopt a more customer-centric business model.

Q What are the main strategic drivers for pursuing acquisitions?



The top risk for M&A is also the top reason deals fail

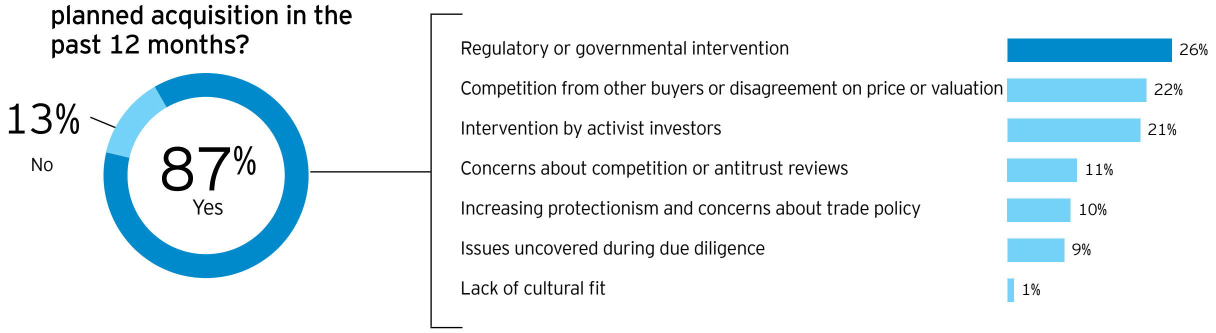
Regulatory intervention creates challenges for dealmaking.

While half of health executives cite regulatory intervention and political uncertainty as the biggest potential risk to dealmaking in the next 12 months, a quarter say it's the reason they couldn't complete deals in the 12 months gone by.

To protect consumer interests, regulatory authorities and governments have increased scrutiny of large M&As. However, the industry is finding innovative solutions to address regulatory resistance, such as looking at vertical integrations to capture large parts of the value chain.

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?



Q What do you see as the biggest potential risk to dealmaking in the next 12 months?

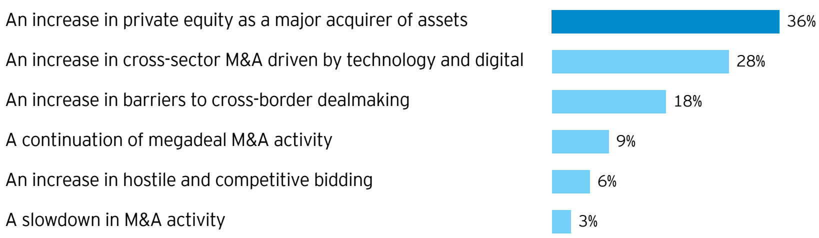
Private equity and convergence set to be the key themes of 2019

Active over the last few quarters, health organizations' private equity's appetite for health assets to continue, increasing competition for assets.

More than a third of health executives surveyed see private equity investment as the key theme in the next twelve months. We have also observed a number of instances in which private equity has partnered with a corporate buyer to invest in US health companies. For private equity firms, this approach reduces risk and provides them with a clearer exit.

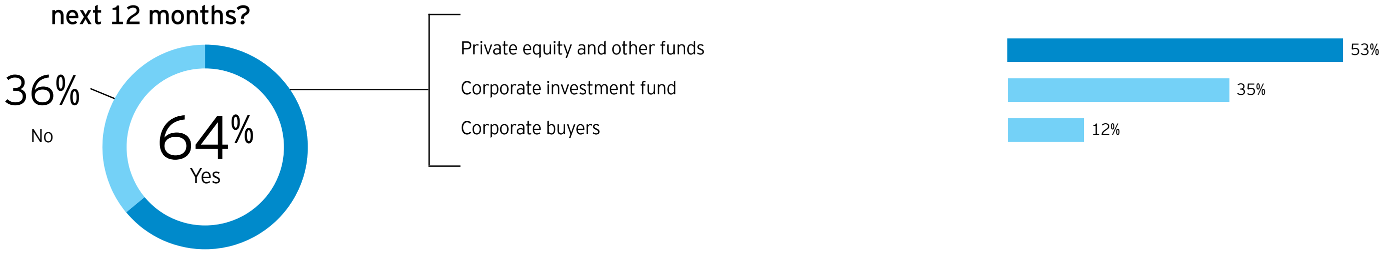
Looking ahead, health executives expect heightened competition for assets, with more than half believing it will come from private equity. The provider segment tops the list for private equity investors. Within the provider segment, retail health continues to see the highest activity. In retail especially, private equity will be able to unlock substantial value through consolidation and improving both the top and bottom line.

Q What will be the main themes of M&A in the next 12 months?



Q Do you expect to see increasing competition for assets in the next 12 months?

Q If so, from where?



Integration and synergies

Pre-deal preparation fails to fully yield anticipated post-deal synergies

Starting the integration process earlier can improve chances to achieve synergies, yet challenges remain.

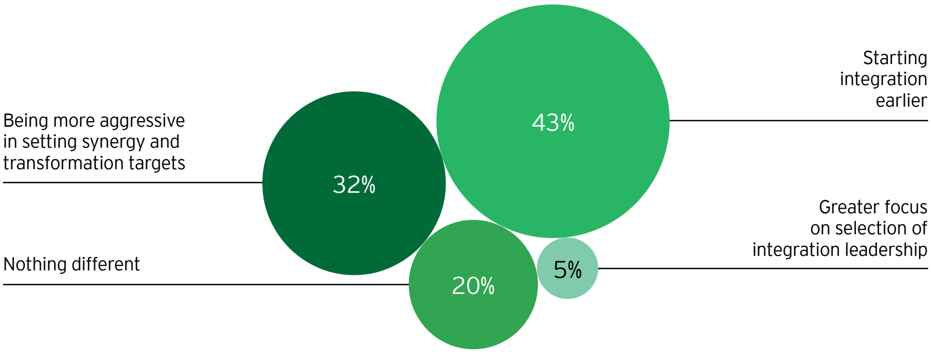
While health organizations remain relatively positive about deal completions, they remain disciplined in their M&A activity. Eighty-seven percent of executives say that they have put the brakes on a deal, citing regulatory or governmental intervention and discrepancies in price or valuation as their primary reasons.

To maximize the synergies of their acquisition, 43% of health organizations say they are starting the integration process earlier in the deal life cycle. They understand that they can only capture the synergies of acquired companies if they map them out upfront and assign accountability for monitoring their progress. This means knowing where value can be created and where the risks lie.

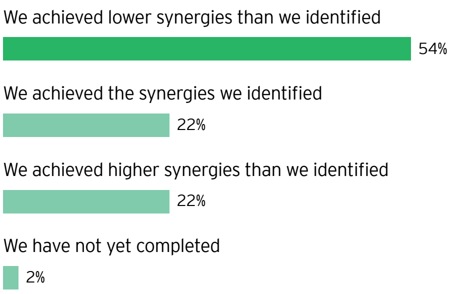
Although 44% of health organizations say they've either achieved or exceeded their synergy targets, the majority (54%) still have work to do as they report having achieved lower synergies than those identified.

A majority of health executives expected technology and bottom-line savings to achieve expected synergies. A quarter say their biggest challenge has been successfully onboarding and retaining talent – a particular sore point given the fierce war for talent and global workforce shortage health organizations face.

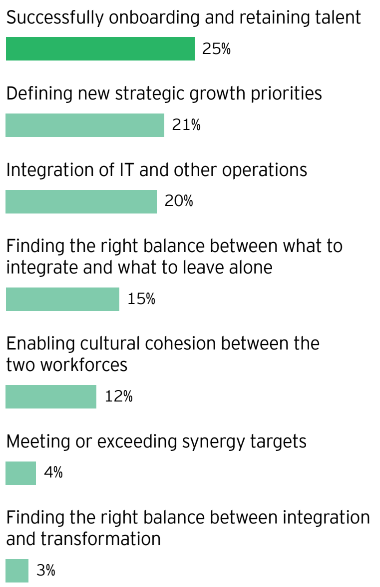
Q In an elevated deal market, what are you doing differently to increase the likelihood of capturing the synergies required to justify the cost of transactions?



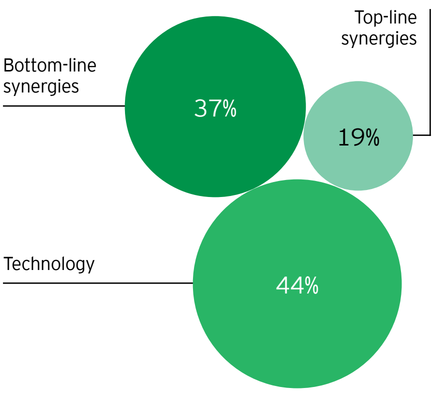
Q What were the achieved synergies compared to the value of synergies identified at the time of the deal?



Q What are the main challenges you face when integrating an acquired company?



Q Where do you expect the majority of synergies to be achieved?



Top investment destinations

Americas and Europe dominate investment destinations

The US is back as a top investment destination. With continued pressure to reduce the health care costs, health organizations in the US have stepped up convergence activities. Non-health sector companies also are increasingly entering the health industry. The UK has retained its second position, mainly due to clarity expected around Brexit as the UK and the EU are in the final phase of negotiations. Canada continues to be on the list. However, its position has slipped from being the top investment destination of choice, even as the government in Canada has taken multiple initiatives to draw FDI from neighboring regions. Meanwhile, Brazil in the number four spot continues to be an important medical tourism destination. It is a hub for cosmetic and plastic surgery and is the third most visited country for medical tourism, after the US and China.

Top five investment destinations

1. United States
2. United Kingdom
3. Canada
4. Brazil
5. France

> The US is back as a top investment destination. With continued pressure to reduce the health care costs, health organizations in the US have stepped up convergence activities.

Contact

For a conversation about your capital strategy, please contact:

W. Gregg Slager
EY Global and EY Americas
Health Leader
Transaction Advisory Services
New York
+1 212 773 8041
gregg.slager@ey.com

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 Capital Agendas — EY 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 August and September, we surveyed a panel of over 2,600 executives in 45 countries; 68% 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, advanced manufacturing, and real estate, hospitality and construction.
- Surveyed companies' annual global revenues were as follows: less than US$500m (25%); US$500m–US$999.9m (23%); US$1b–US$2.9b (21%); US$3b–US$4.9b (9%); and greater than US$5b (22%).
- Global company ownership was as follows: publicly listed (56%), privately owned (39%), family owned (2%) and government or state owned (3%).

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY's Transaction Advisory Services
How you manage your capital agenda today will define your competitive position tomorrow. We work with clients to create social and economic value by helping them make better, more-informed decisions about strategically managing capital and transactions in fast-changing markets. Whether you're preserving, optimizing, raising or investing capital, EY's Transaction Advisory Services combine a set of skills, insight and experience to deliver focused advice. We can help you drive competitive advantage and increased returns through improved decisions across all aspects of your capital agenda.

EYG no. 012592-18Gbl

1808-2856410

ED None

ey.com/ccb