

**strategy&**

Formerly Booz & Company

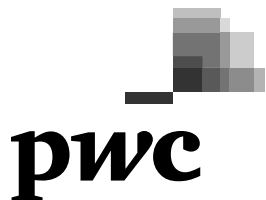
May 30, 2016

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# *Project Mancho*



## Kick-off Meeting



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## ***Content***

- |  |               |
|--|---------------|
| <b>1) Recap of Objective and Context</b> | <b>10 min</b> |
| 2) Key trends of China healthcare market | 30 min        |
| 3) Project Approach                      | 30 min        |
| 4) Initial Hypothesis                    | 30 min        |
| 5) Work Plan & Schedule                  | 20 min        |

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## *Khazanah China Healthcare Vision by 2020*

### Major Strategic Healthcare Investor in China by 2020

#### **Our interpretation:**

- **“Major”** refers to **“being highly recognized as an important investor”** in China healthcare industry, which can result from investment into landmark projects/deals or involvement in building well-known healthcare platform
- **“Strategic”** refers to **“having majority ownership or having strategic influences and contributions”** on the invested projects; strategic link to IHH should also be considered
- **“Healthcare”** primarily refers to **“hospitals”** and would also cover medical tourism and day surgery centre on opportunistic basis

## ***Key questions to be addressed in this project***

<b>Key Questions</b>	<b>Why Important</b>	<b>How to Address</b>
<b>Where is the market opportunity?</b>	Identification of market landscape and set up the directions for investment	<ul style="list-style-type: none"> <li>• Market study overview</li> </ul>
<b>How big and where is the premium healthcare sector? Which specialty?</b>	Specialties with large market size/gap & high premium penetration	<ul style="list-style-type: none"> <li>• Premium/private market sizing</li> <li>• By specialty market sizing</li> </ul>
<b>Should we focus on public or private hospitals?</b>	Public and private targets require different investment models/strategies	<ul style="list-style-type: none"> <li>• Public/private market sizing</li> <li>• Market segmentation &amp; prioritization</li> </ul>
<b>Should we invest in single hospital or a platform?</b>	Single hospital / platform means different investment strategies & ROI	<ul style="list-style-type: none"> <li>• Investment feasibility check</li> </ul>
<b>How to identify the potential platform targets?</b>	Determination of potential targets and investment approach	<ul style="list-style-type: none"> <li>• Long-list generation &amp; short-list screening</li> </ul>
<b>Why and how to involve in public hospitals as foreign investor?</b>	Public sector is major component of China's healthcare market	<ul style="list-style-type: none"> <li>• Policy overview</li> <li>• Investment model analysis</li> </ul>
<b>Should we partner with other players? Why and who?</b>	Partnership with strategic investors enables more availability / flexibility	<ul style="list-style-type: none"> <li>• Potential partner identification</li> </ul>
<b>What should / can be our value proposition to the targets?</b>	Set up the basis of investment strategies and negotiation basis	<ul style="list-style-type: none"> <li>• Internal capability check</li> <li>• Value additions</li> </ul>
<b>How can IHH best involved or being leveraged?</b>	Key value additions to potential targets	<ul style="list-style-type: none"> <li>• Access to IHH information and strategic intentions</li> </ul>

# ***Project Context, Objectives and Key Deliverables***

## **Context & Objectives**

- You have invested into IHH (international premium hospital network) as largest shareholder
- Healthcare in China is identified as a strategic area to invest and focus for Khazanah
- You expect to establish a clear understanding of the China healthcare market from demand-supply policy, payor, etc. perspectives so as to assist you identifying segments with higher attractiveness for you
- Hospitals would be the primary focus while day surgery centre and medical tourism is also of interests
- For high attractiveness segment, you would expect to have a deep-dive understanding and to identify potential business models and targets to build up your own healthcare investment portfolio

## **Key Deliverables**

**1**

### **Market Analysis**

- An overview of China healthcare market including demand-supply, policy, payor, physician system that would help to identify high attractiveness segments
- Deep-dive quantitative and qualitative analysis into high-attractiveness segments to further analyse the opportunities

**2**

### **Investment Strategy**

- Establish investment strategy options based on market analysis
- Prioritize among options with capabilities requirements and viable business models
- Develop screening criteria for priority options

**3**

### **Target search & screen**

- For the priority investment options, generate long-list targets
- Screen and identify short-listed targets and provide suggestions on next steps

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# *Key trends in China healthcare market*

1

## **Macro / Policy Trends**

- China's healthcare market is large, rapidly growing, and fast evolving, driven by favorable demographic trends
- Policy is guiding the industry to be more diversified, balanced, specialized, and transfer the development focus from medical care to healthcare

2

## **Industry Landscape**

- Public hospitals still dominate the market, but are facing capacity constraints and structural challenges
- Private hospitals are fast emerging driven by growing demand and policy support, but challenges remain

3

## **Investment Trends**

- Investment into healthcare services industry increased significantly in recent years; the investment into public hospitals remains challenging but happening in small scale now
- Previously the investment focus was in specialty hospitals, now, a trend to invest into general hospitals is being observed

# China healthcare reform starting in 2009 is changing the whole industry from its foundation

## Government Goals for Healthcare Reform

### Government's Goal

**Cut the grey connection between hospital and pharmaceutical to;**

- Push hospital and physicians to focus on **improving medical service**
- **Control overall spending** for patients and government
- **Improve efficiency** in public hospitals



### To improve Healthcare

- **Accessibility**
- **Affordability**
- **Service level**

## Areas of Reform

<b>Hospital Reform</b>	Hospital Ecosystem
	Public hospital reform
<b>Medical Insurance</b>	Reimbursement Mechanism
	Insurance Coverage
	Centralized Government Regulation
	Distributor's value chain expansion

## Government Policy

- Promote hospital classification
- Multi-site practice
- Zero-mark-up
- Introducing private capital
- No country-wide policy, local policy is different
- Encourage commercial insurance development
- Resource allocation by market
- Insist major share of public hospitals
- Support vertical integration to facilitate public hospital reform

## Market Trends

- Primary care would develop and diversified
- Multi-site practice would be adopted in hospital groups
- Emergence of private hospital
- Separation of hospital pharmacies
- Separation of regulation and operation
- More strict cost control through global budgeting and DRGs
- High penetration of Basic Medical Insurance Schemes
- Emergence of commercial insurance
- Centralized government power to oversee the healthcare reform
- Expansion of distributors to enter SPD business, and even in hospital investment



*The market will be very different in 2020, creating many opportunities*

**Past**

- A relatively **unitary** market
- **Basic public medical insurance** dominant
- **Large public hospitals** dominant
- Focus on **communicable diseases**
- **Traditional ways** of marketing and selling



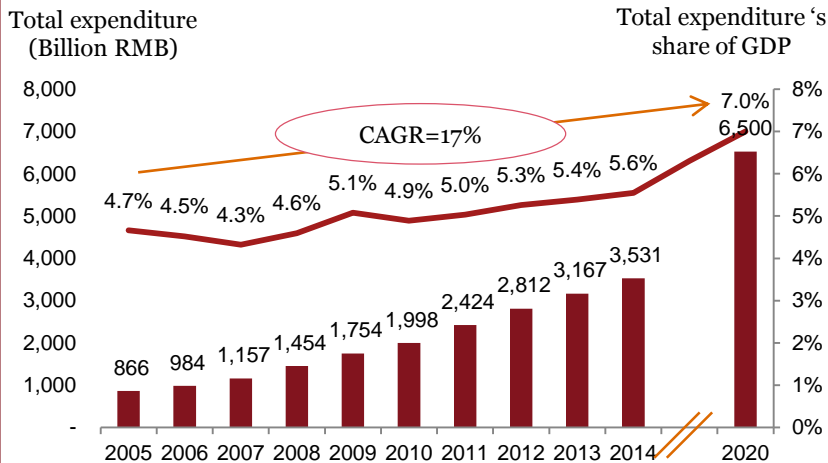
**2020**

- Emerging of **two segments** – “Mass Market” and “High End Market”
- Both **Public** and **Private** insurance
- More **balanced structure** with private healthcare institutions emerging as key healthcare supplier
- **Chronic disease management** increasingly important
- More sophistication needed, **with Digital** creating new ways to play

# China total healthcare expenditure will keep growing at a high CAGR and the society will become the major financing source

## China total healthcare expenditure

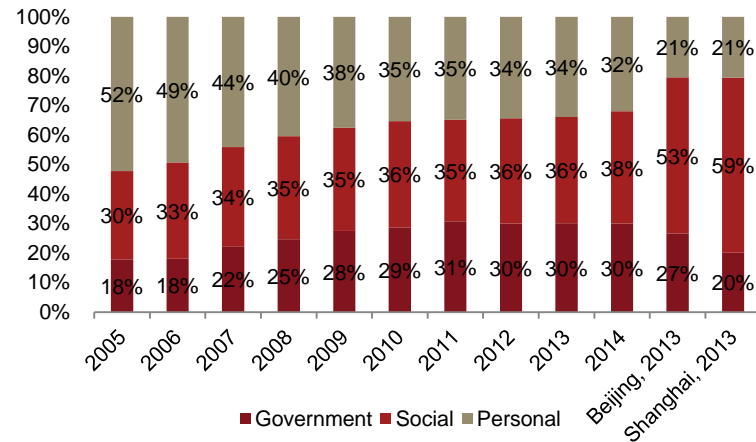
China total healthcare expenditure, 2005-2020



- High historical growth rate
- Relatively low compared with GDP
- According to MOH's plan, the total expenditure CAGR will keep 11% from now to 2020, reaching 6,500 billion RMB

## Financing structure of healthcare expenditure

Financing structure of China healthcare expenditure, 2005-2014



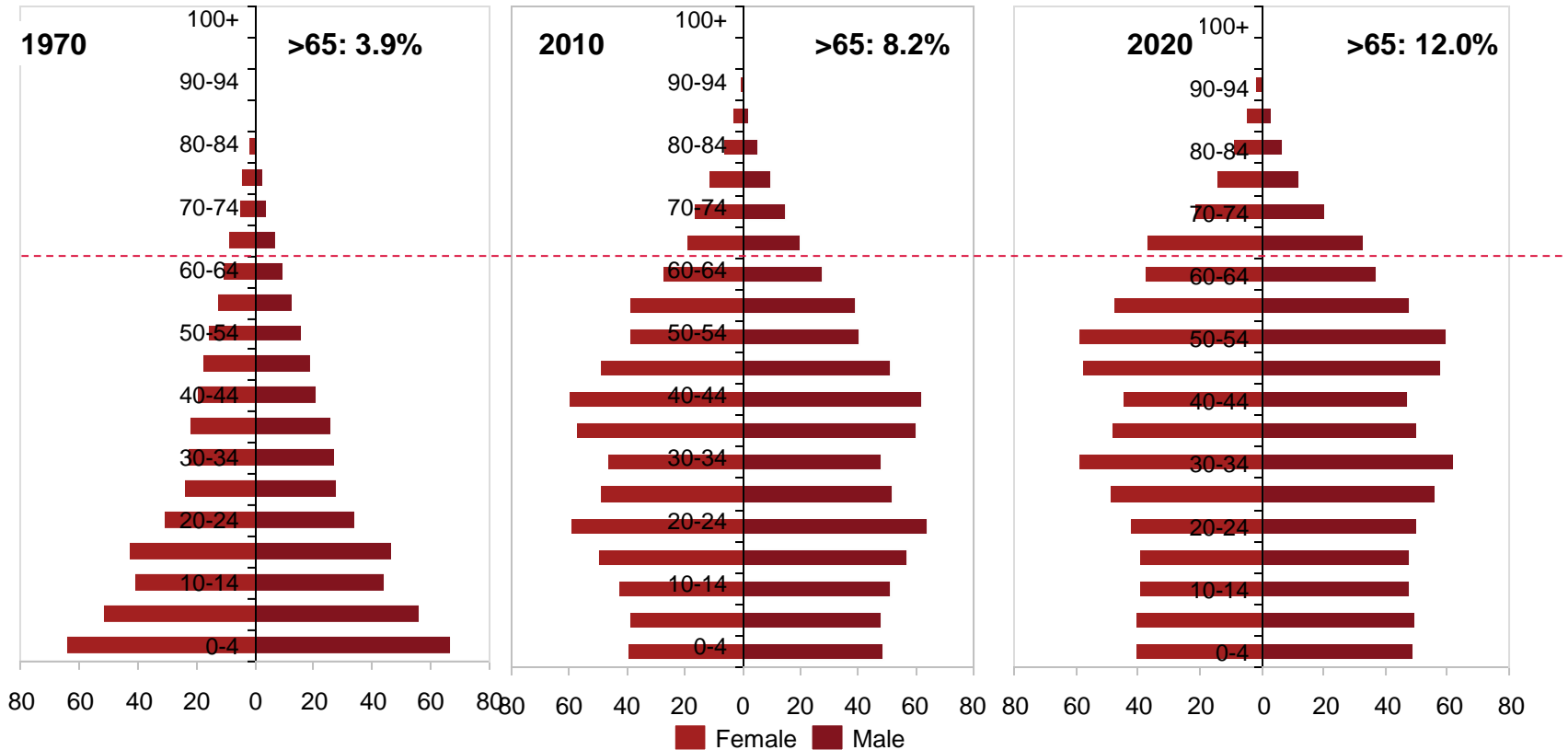
- Society (mostly means the social medical insurance) will gradually become the major financing source which has been proven in Shanghai and Beijing

Source: China Healthcare Year Book 2015, Strategy& Analysis

# The large and rapidly growing aging population is a key driver for healthcare demand in the next decade

Chinese Population Distribution by Age Groups

Unit: Million Population



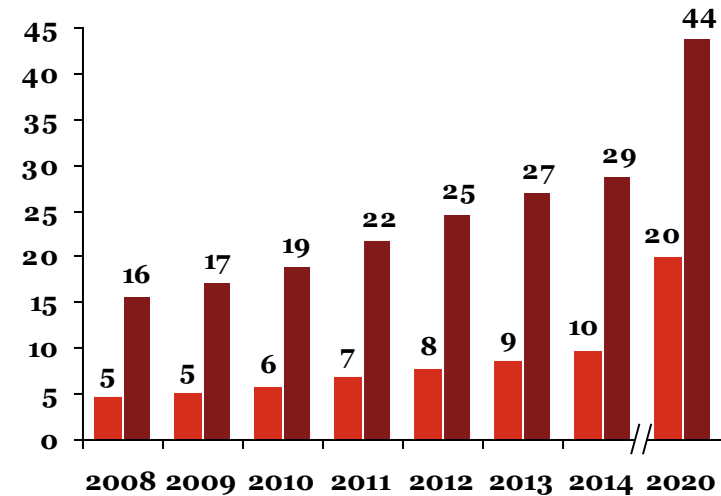
Source: UN World Population Prospects; Morgan Stanley Research; Global Insight; Strategy& analysis

# Chinese consumers are earning more income thus higher affordability of better healthcare services

## Chinese Consumer Average Income

Income per Capita, China, 2008-2020

'000 RMB



■ Net income per capita in rural area CAGR 12%  
■ Disposable income per capita in urban area CAGR 7%

## Positive influence on healthcare industry

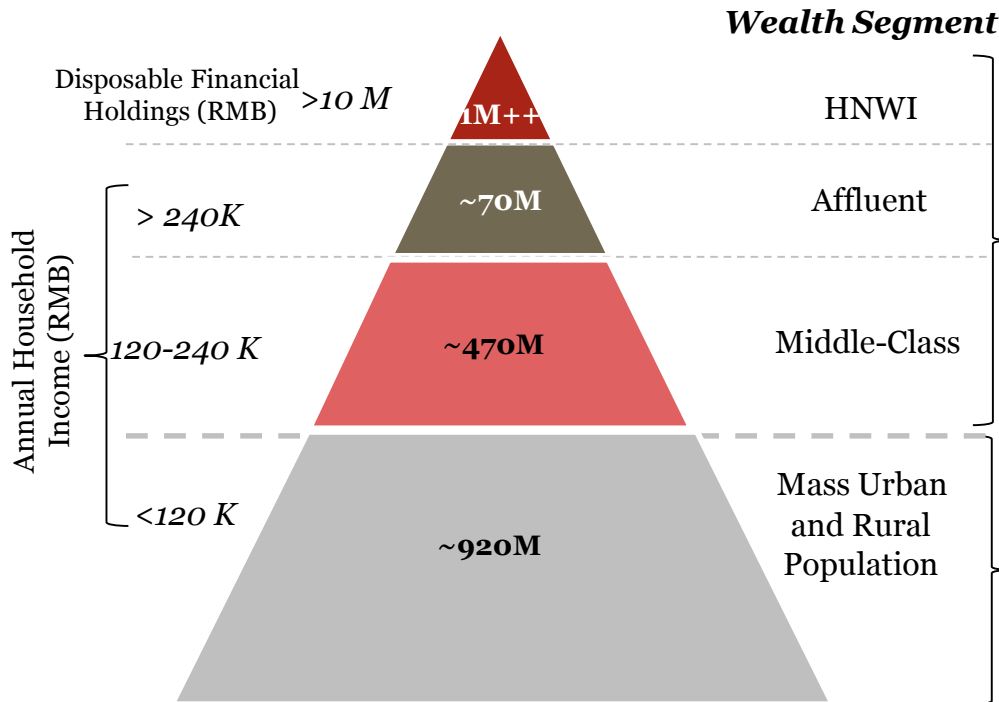
Growing income of Chinese consumers will drive higher demand for better healthcare services:

- **Clinical service**
  - Better treatment
  - Personalized medication
  - Better clinical outcome
  - ...
- **Non-clinical service**
  - Better service
  - Higher efficiency
  - Better environment
  - ...
- **Related industry**
  - More mature commercial healthcare insurance
  - Larger hospital management and healthcare education market
  - ...

Source: Ministry of Human Resource and Social Security, Strategy& Analysis

# China has a very large high-income consumer pool that demands higher quality care

**Population by Wealth Segment**  
(Total Population of 1.46B, 2020)



## Demand for Healthcare Service

**High-end Healthcare Service**

- Demand for access to advance care with better service
- Less price sensitive
- High penetration of commercial health insurance (high affordability)

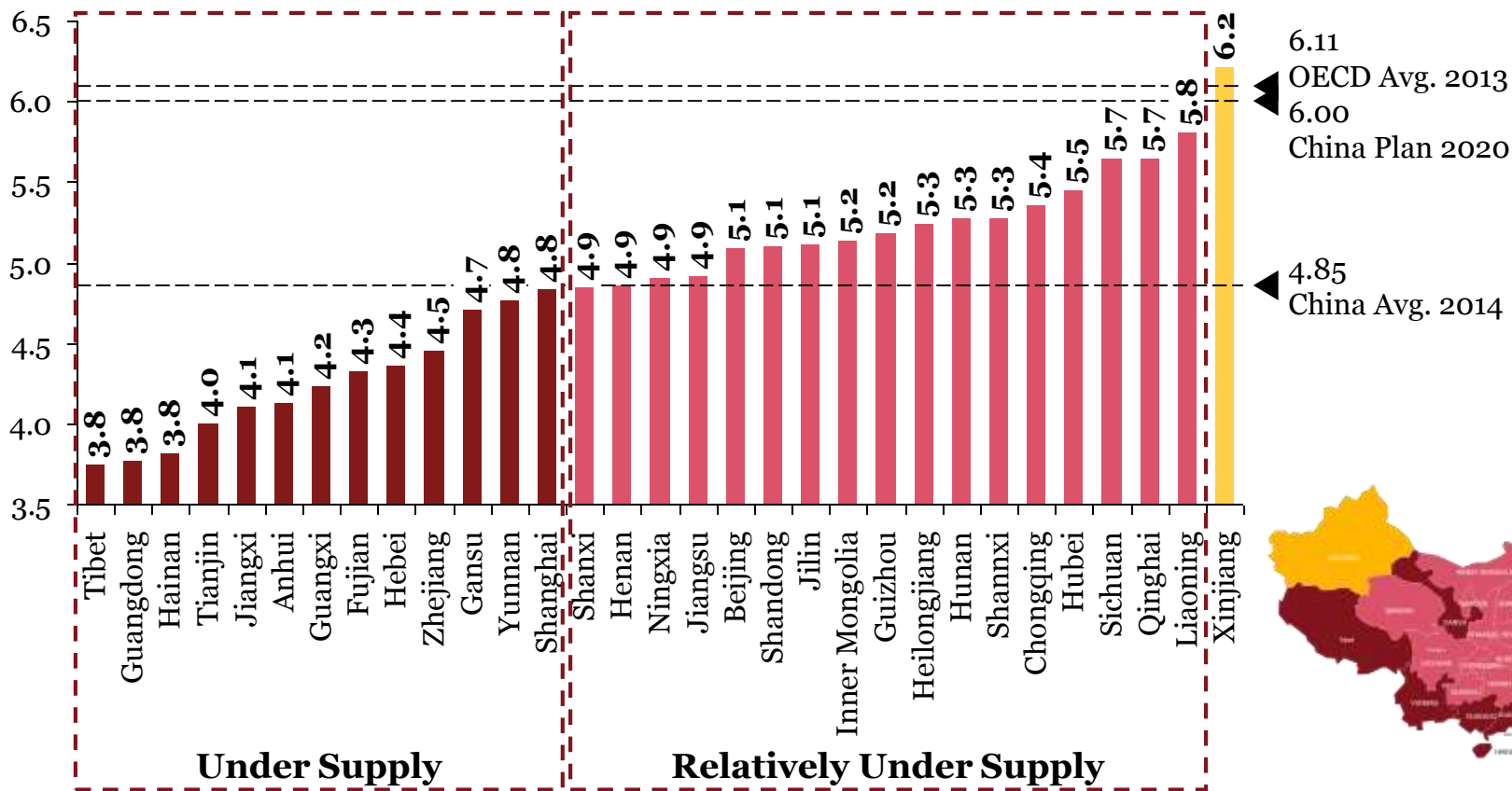
**Basic Healthcare Service**

- Demand for better access to reliable healthcare services
- Still high price sensitivity
- Covered by public basic medical insurance schemes

Source: China Wealth Management Year Book 2011; literature research; Strategy& analysis

# Compared with OECD and China average level of beds per 1,000 inhabitant, 13 provinces exist big demand-supply gap

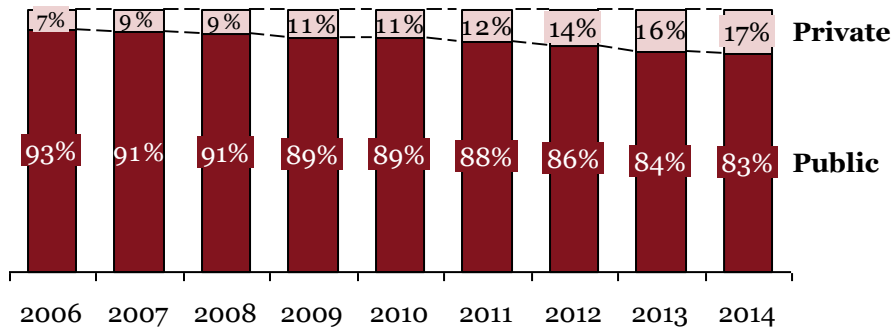
Hospital beds per 1,000 inhabitant



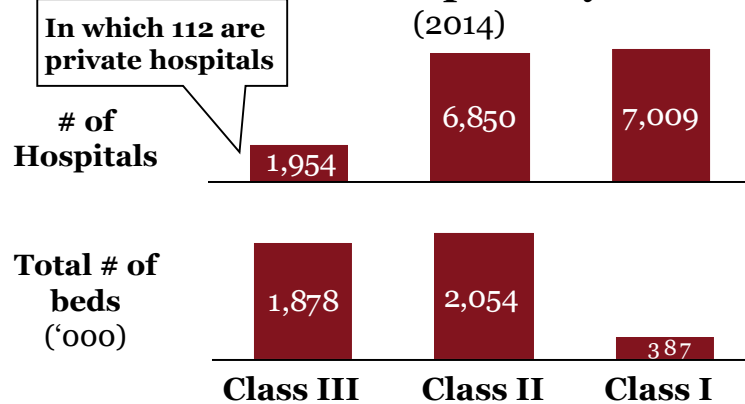
# Public hospitals still dominate the market, thus, it could be hard to exclude public hospital as strategic investors

## Chinese Hospital Beds

(%, Public vs. Private, 2006-2014)



## Chinese Hospitals by Class



- Public hospitals in China is dominating the healthcare market over the private sector not just from the scale perspective, high quality talent is another important barrier
- For Khazanah, investing into public hospitals can be challenging from various perspectives but we still suggest this should be included in your strategic picture

Source: Chinese Health Yearbook 2013, National Bureau of Statistics of China, Strategy&/PwC analysis

## *There are 3 typical methods to invest/participate into public hospitals in China*

Investment Method	Description	Class 3A hospitals owned by government	Class 3B and Class 2 hospitals owned by government	Hospitals owned by SOEs (Class 3 or Class 2)
Transform and acquire	Direct transform the hospital and acquire it	<ul style="list-style-type: none"> <li>Very difficult, pending on policy</li> </ul>	<ul style="list-style-type: none"> <li>Possible</li> </ul>	<ul style="list-style-type: none"> <li>Possible</li> </ul>
Entrusted management	Obtain the control power of the hospital without change the owner	<ul style="list-style-type: none"> <li>Very difficult, pending on policy</li> </ul>	<ul style="list-style-type: none"> <li>Possible</li> </ul>	<ul style="list-style-type: none"> <li>Possible</li> </ul>
Green field	Partnering with public hospital to develop a new JV hospital	<ul style="list-style-type: none"> <li>Possible</li> </ul>	<ul style="list-style-type: none"> <li>Not worthy</li> </ul>	<ul style="list-style-type: none"> <li>Can consider if for leading Class 3A hospital</li> </ul>

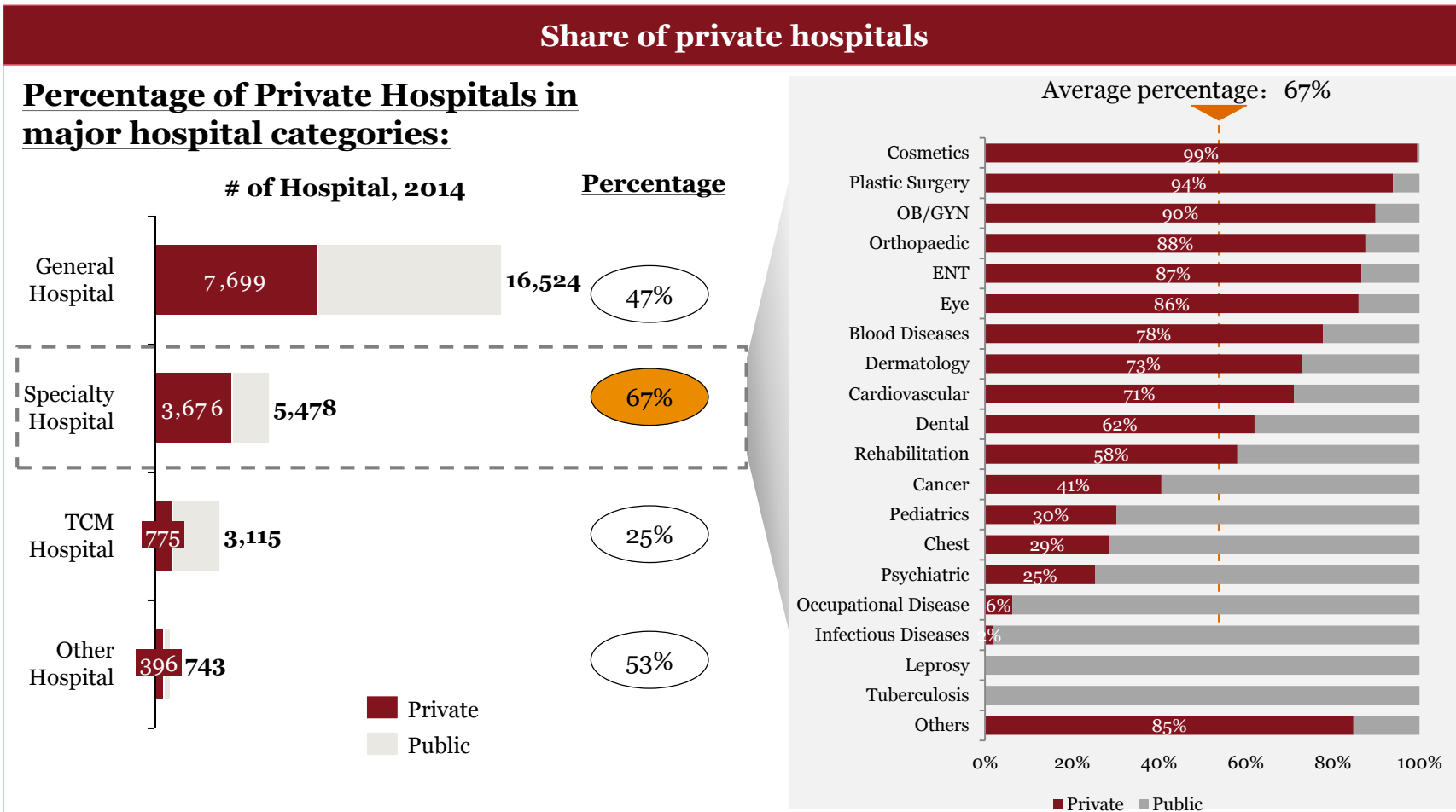
**For government-owned public hospitals, often time the deal viability is driven by local Health Bureau**

**For SOE-owned hospitals, the decision is normally at SOE group level**

Source: Chinese Health Yearbook 2013, National Bureau of Statistics of China, Strategy&/PwC analysis



# Private sector has gain significant share in specialty hospitals



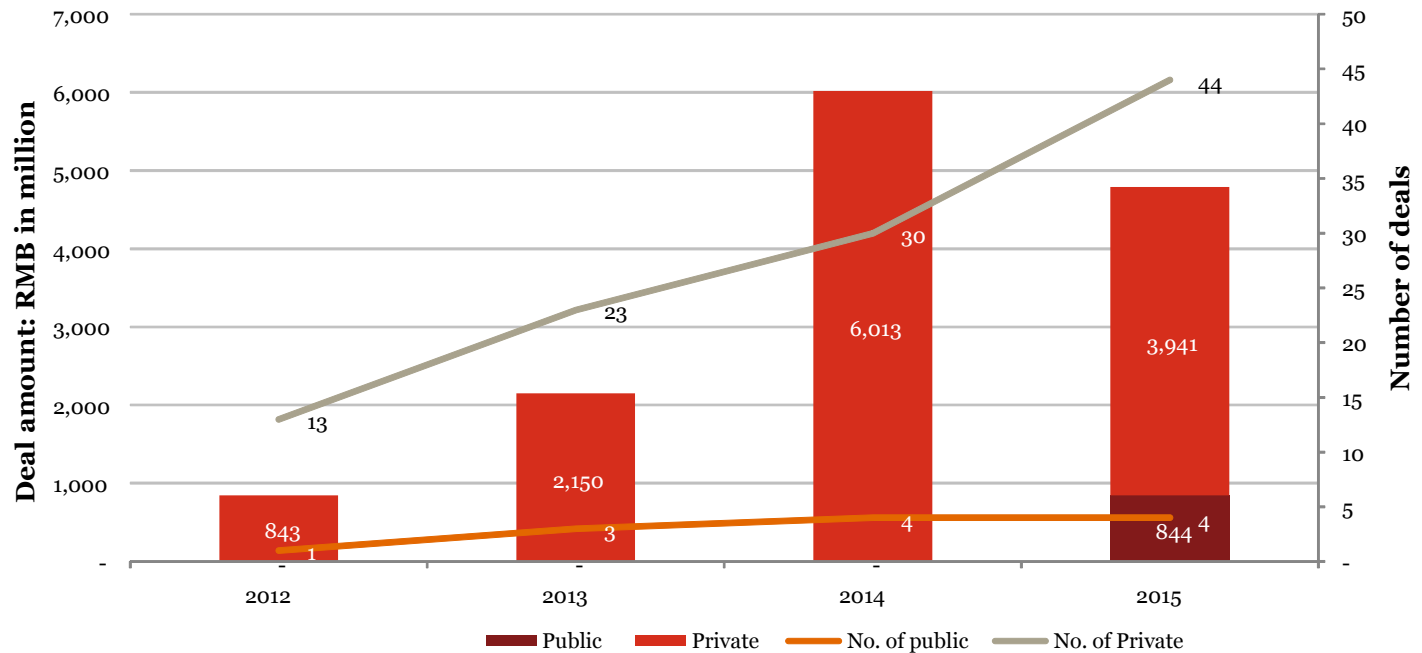
Source: China Healthcare yearbook, Expert interviews, PwC analysis

# Investments in private hospitals have risen substantially since 2014, reaching record highs in deal volume and value

**Key trends include:**

- Following the highs in 2014, deal amounts plunged to RMB3.94 billion in 2015, with fewer deals associated with specialized hospitals made.
- Conversely, Public hospital investments saw more activity in 2015, with disclosed deal value totaled RMB0.84 billion.

## Deals in domestic hospitals from 2012 to 2015 (by hospital type)

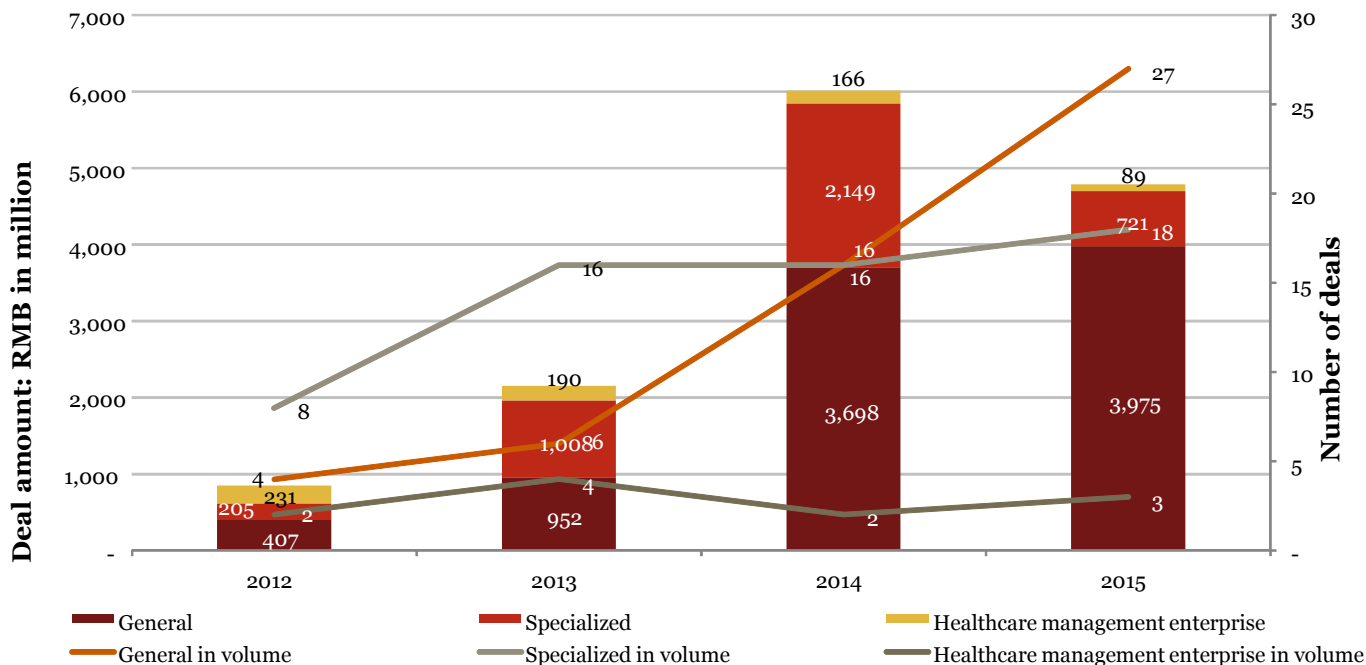


30 deals in which deal value remains undisclosed are not included in the value figures in this analysis

Source: Zero2IPO Research, Thomson Reuters, and PwC analysis

# Domestic M&A investments into general hospitals outpaced the growth of investments in specialized hospitals in 2014

Deals in domestic hospitals from 2012 to 2015 (by hospital type)



30 deals in which deal value remains undisclosed are not included in the value figures in this analysis

Source: Zero2IPO Research, Thomson Reuters, and PwC analysis

## *Currently most day surgery centers are part of major hospitals and standalone ones are yet to emerge*

### Major Observations

#### Day Surgery Centers Attached to Hospitals

- By 2015, there are c.30 hospitals in China that have set-up a separate Day Surgery Centers (physically attached to hospitals)

#### Day Surgery Conducted at Different Hospital Sections

- About another 100 hospitals that offer day surgery without a separate day surgery centers

#### Standalone Day Surgery Centers

- Not yet observed in China

- Most hospitals offering day surgery options are level 3 hospitals that have tight bed supply and day surgery can help to increase the hospital bed turnover
- Medical insurance policy also limit the day surgery reimbursement to level 2 or above hospitals
- Surgery outside hospitals are not yet well accepted in China
- Business model for standalone day surgery centers are not clear at current time (i.e. relationship with doctor, medical liabilities, etc.)

#### **Implication:**

- No investable standalone target exists in the market
- The demand is the same with in-patient surgery services, and its penetration is mainly driven by policy

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