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Swiss hospitals: Finance health check 2016

*The Swiss healthcare
landscape in a state of flux*



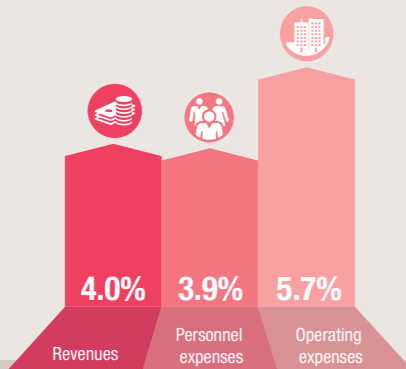
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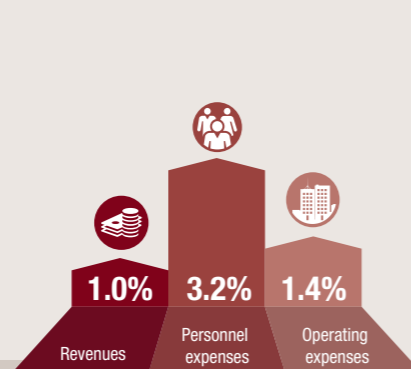
Acute care

Psychiatric care

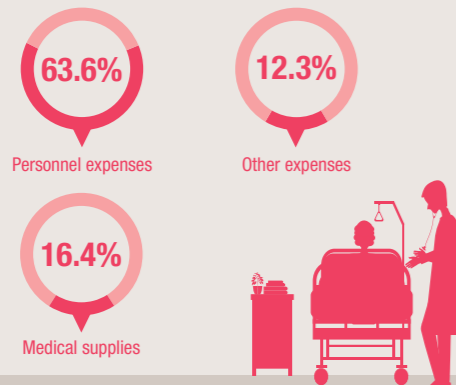
Growth rates in 2016



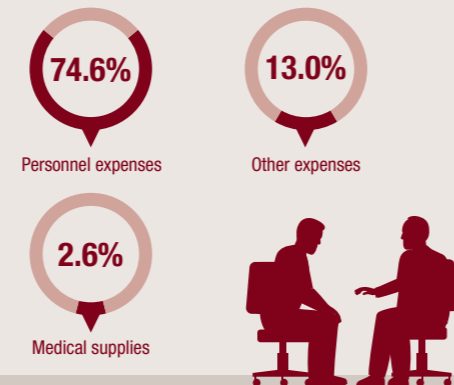
Growth rates in 2016



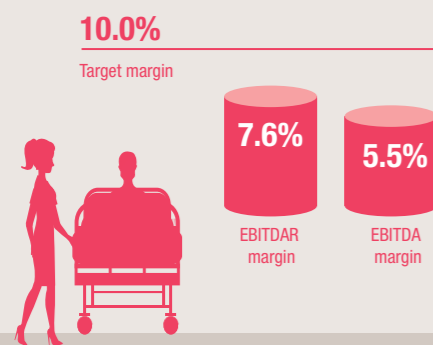
Breakdown of costs in 2016 (% of revenues)



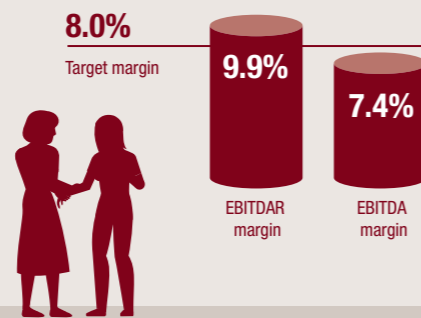
Breakdown of costs in 2016 (% of revenues)



Profit margins in 2016



Profit margins in 2016



Swiss hospitals: Finance health check 2016

The Swiss healthcare landscape in a state of flux (english excerpt)

Developments in healthcare continue to gather pace. Hospitals face increasingly intense – though regulated – competition. A focus on performance and economic considerations is now a permanent feature of corporate management. Rising patient expectations, major construction projects, sustainable financing

solutions, optimised models of care and new job profiles – these are some of the important changes and challenges in the Swiss healthcare industry, and are the focus of the sixth and latest study in the PwC “Swiss Hospitals: Finance health check 2016” series.

Significance of financial performance data for hospitals

The EBITDA margin is broadly accepted in the Swiss hospital sector as a key indicator of profitability. The benchmark figure of 10% for the EBITDA margin mentioned by PwC back in 2011 is currently used in many hospitals’ corporate and ownership strategies.

The long-term EBITDA benchmark target is derived through a theoretical method based on the market approach. Based on the latest calculations, this produces a target EBITDA margin of 9–12%. Taking into account the tax-exempt status of many public sector hospitals, the calculated minimum range can be reduced by around 1% to 8–11%. Overall, this shows that the benchmark of 10% for the EBITDA margin or EBITDAR margin for hospitals tied to a rental agreement also holds true in the current context. For psychiatric clinics this margin can be slightly lower as they tend to invest less in expensive technical equipment compared to acute care providers.

Essentially, hospitals must generate enough income to be able to fund the necessary long-term investment themselves. Therefore, lower or higher margins may be required depending on the starting point and investment level of the individual hospital.

The profitability of Swiss acute care hospitals is stagnant and on average clearly too low

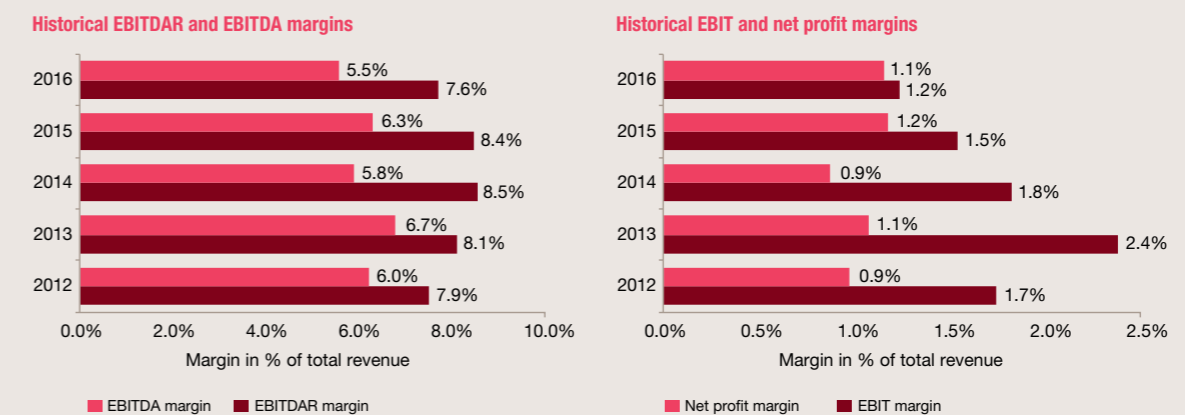
Analysis of the financial performance data shows little change in the healthcare market since the last study. Similar growth can be seen on both the earnings and the costs side, which is why the profitability of Swiss acute care hospitals was stagnant or fell slightly in 2016. The capital structure analysis shows a similar pattern.

Stagnant profitability

On average, the 45 analysed Swiss acute care hospitals proved less profitable in 2016 than in the previous year. This can be clearly seen in the EBITDAR and EBITDA margin and – somewhat less so – in the EBIT and net profit margin.

In the profitability analysis, the results show a relatively wide spread. The trend is quite stable; five of eight hospitals with an EBITDA margin of more than 10% already exceeded the 10% mark in the previous year. In addition, many hospitals continue to show low EBITDA margins. This may lead to an increase in improvement and restructuring projects.

Figure 1: Profitability trend of Swiss acute care hospitals

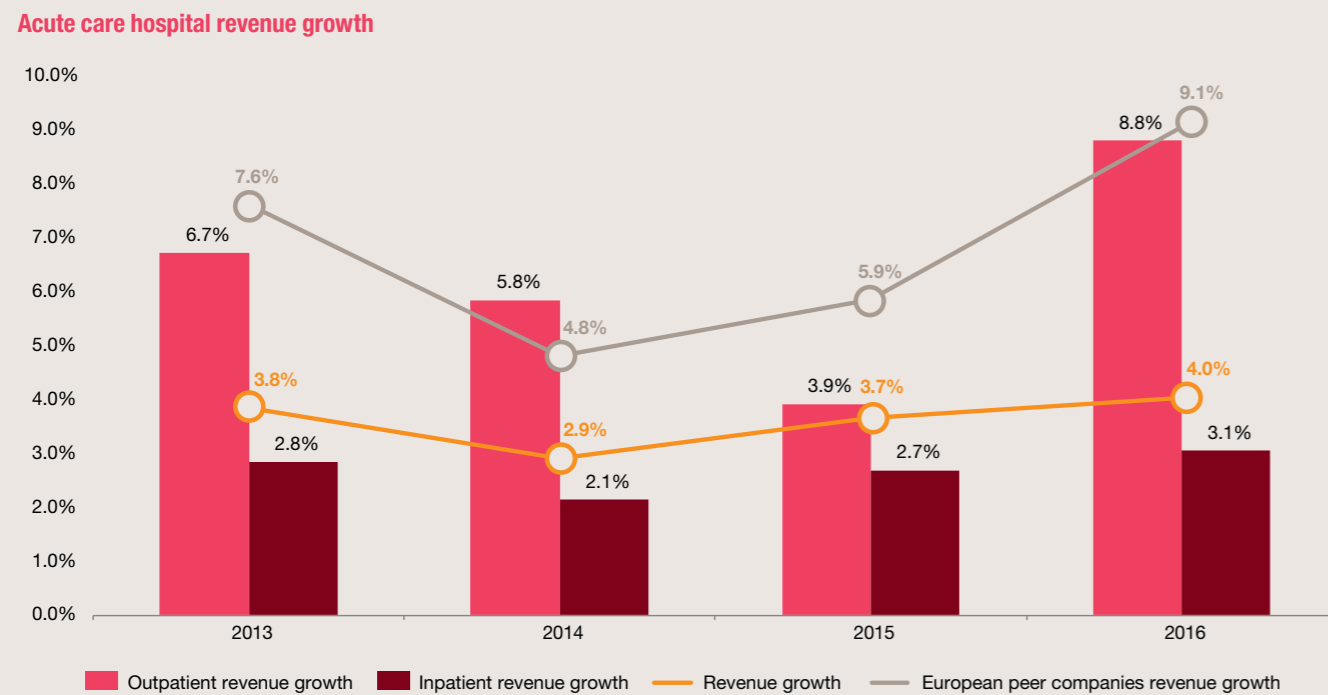


Continuing trend of “outpatient before inpatient”
 Since the introduction of Swiss DRG in 2012, Swiss hospitals have seen revenue growth of 3.6% each year (median).

The outpatient sector had above average growth. For example, revenue in 2016 grew by around 8.8% (median). Comparing outpatient growth with inpatient growth, outpatient growth in 2016 was more than twice as high as the growth of the inpatient sector. There are various reasons for this, including medical advances, the principle “outpatient before inpatient” and the new patient needs. In

future, regulatory interventions or new tariff systems (e.g. zero-night or one-day DRG) will also play a role. The “outpatient before inpatient” trend will continue, and many hospitals are already pro-actively forging ahead with this or will do so with new operating models. This is being done despite the tariff intervention of the Swiss Federal Council, which will reinforce the current bias between outpatient and inpatient tariffs. However, in order to fully exploit the potential of outpatient treatments, hospitals must be properly compensated.

Figure 2: Revenue growth in acute care, split by outpatient and inpatient revenue



Financial challenges for psychiatries

In contrast to acute care, psychiatric clinics are yet to tackle the issue of transformation in terms of changing the tariff system. It remains to be seen to what extent TARPSY will affect the financial results of psychiatric clinics, and whether changes to the tariff structure are needed.

Stagnant growth and trend towards outpatient treatment

In 2016, PwC studied twelve psychiatrists (compared to eleven in the previous year). Just as in acute care, a trend towards shorter stays and outpatient care was seen among psychiatries. Revenue growth from 2013 to 2016 showed a median of 1.5% in the study sample.

Steady profitability of psychiatric clinics in recent years

The profitability of Swiss psychiatric clinics was somewhat weaker than in the previous year: although the EBITDAR margin for 2016 showed a median of 9.9%, which represented a rise of 0.7%, the EBITDA margin of 7.4% was 0.8% below the previous year's figure.

The switch to the new TARPSY inpatient tariff system and its consequences, which remain to be seen, poses a considerable challenge to the financial management of Swiss psychiatries. In contrast to the current situation, i.e. planning based on general daily rates, TARPSY forces psychiatries to fine-tune their activity planning specifically according to psychiatric cost groups (PCG) and phase. This increases the importance of internal medical financial controlling and financial planning, as well as the need for detailed business plans with planning alternatives.

Figure 3: Revenue growth in psychiatries, split by outpatient and inpatient revenue

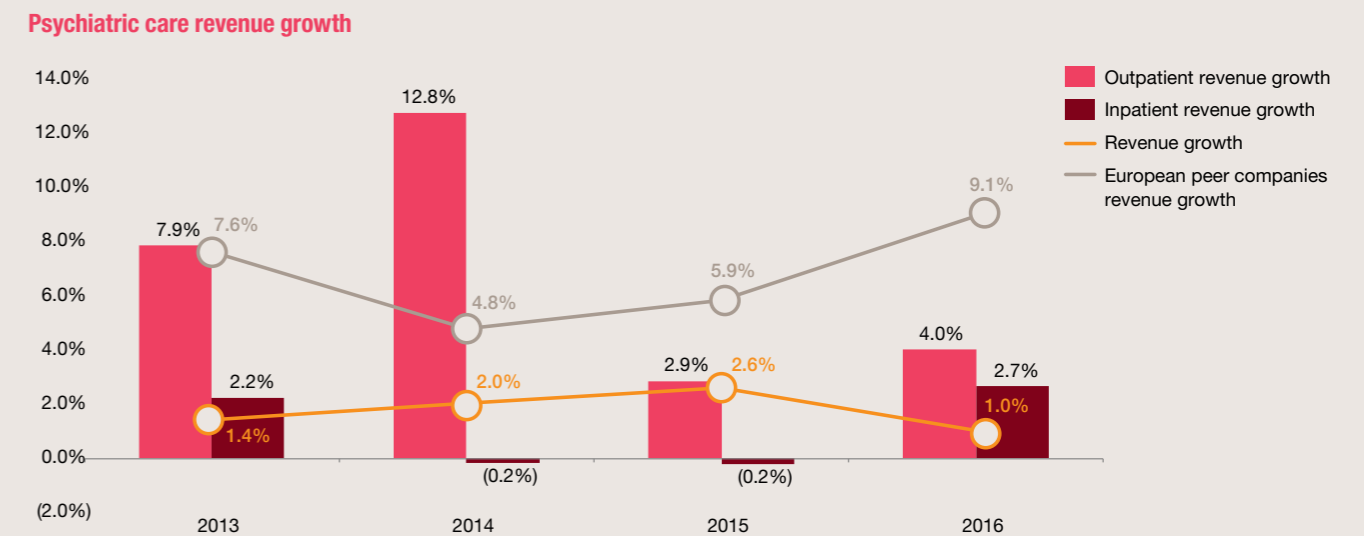


Figure 4: Profitability trend of Swiss psychiatric care

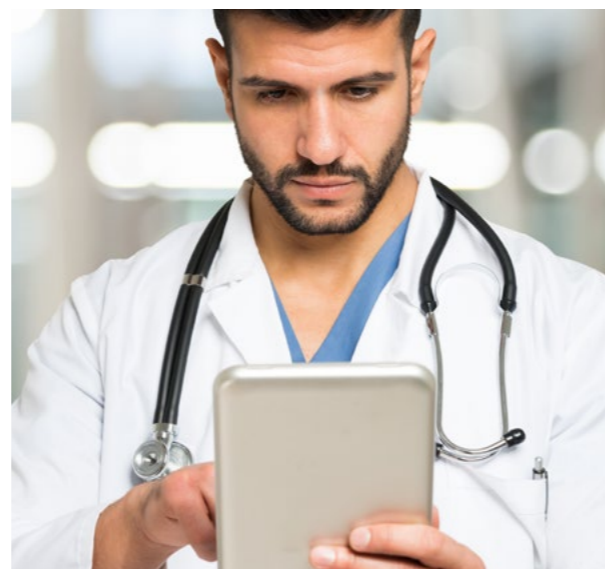
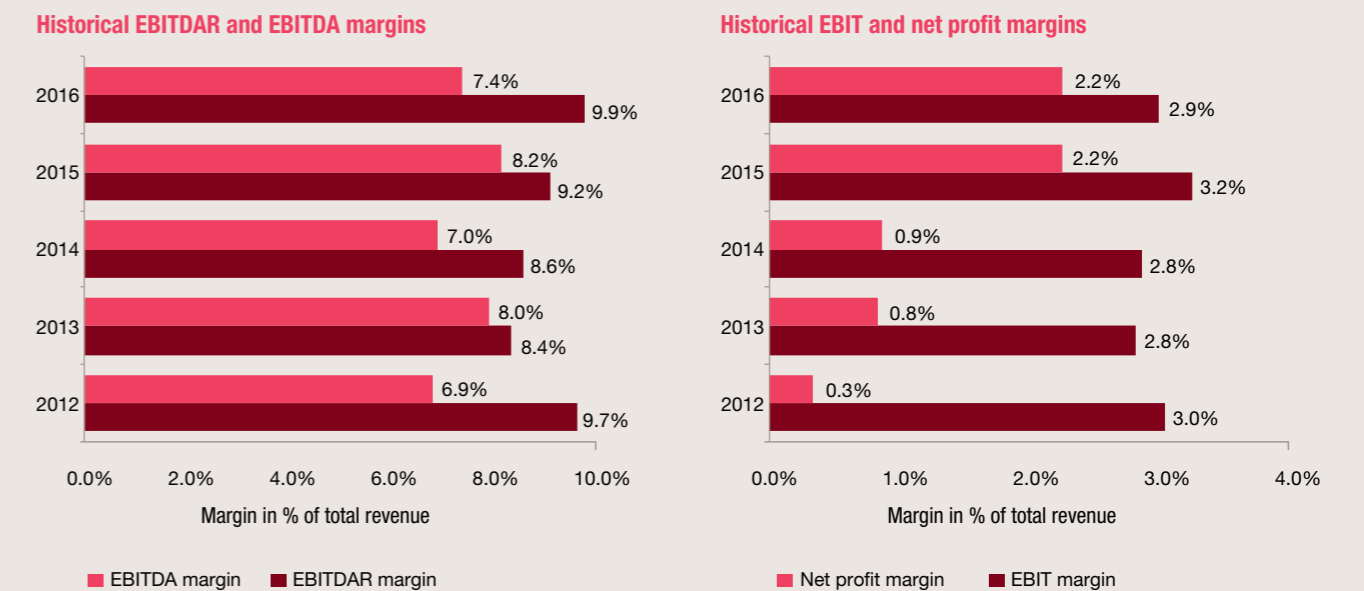
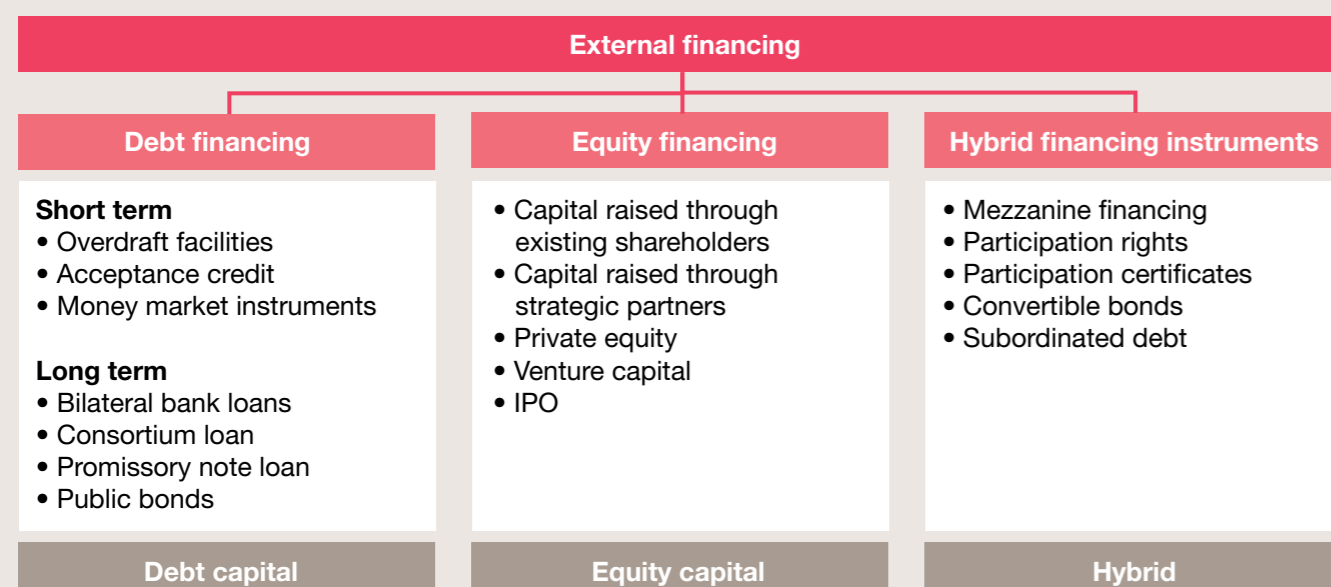


Figure 5: Overview of the main external financing options



External financing today and in the future

External financing options for Swiss healthcare providers

The financing options for Swiss healthcare providers have changed drastically. Alongside internal financing through resources generated by the hospital itself (operating cash flow or divestments), external financing with resources which do not come from the hospital's current value creation process play an increasing role, especially when it comes to major investments.

Credit and capital markets

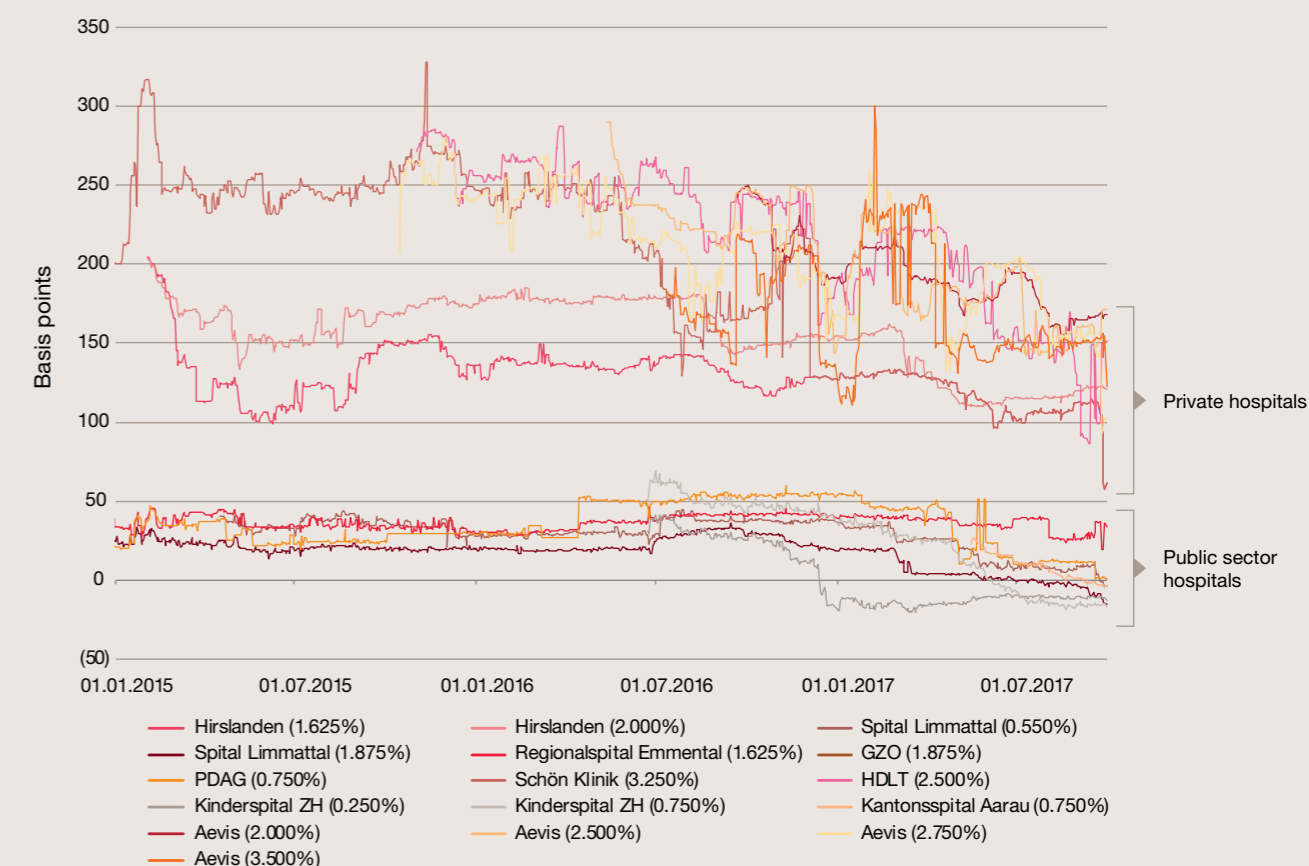
While short-term financing instruments such as overdraft facilities were used long before the introduction of the new hospital financing, long-term financing instruments through the credit and capital markets have only been the focus of attention since 2012. The most frequently used long-term debt capital instruments are classic bilateral

bank loans, consortium loans, promissory note loans and public bonds. Our actual hospital study shows the various financing instruments in detail, and their differences, benefits and drawbacks.

Bonds from private and public sector hospital issuers have performed well on the secondary credit markets, and now represent an established financing instrument. Evidence of this is provided by the gradually falling risk premiums since 2016 (lower Z-spreads).

Essentially, the Z-spread varies according to business and financial risk, though the ownership structures of the hospital issuer also have a significant influence on it. Privately owned hospitals have a higher Z-spread of around 100 basis points on the Swiss secondary market for hospital bonds compared with publicly owned hospitals.¹ This indicates that investors require a higher return on investments in private hospital in order to compensate for the higher level of credit risk.

Figure 6: Trend of the Z-spreads of private and public sector hospitals since 2015



Financing process and challenges for management

The financing process normally runs over several months and in five phases:

- 1) Initial analysis and development of the financing concept
- 2) Marketing and market analysis
- 3) Pre-deal negotiations, due diligence and binding offers
- 4) Final negotiations and signing
- 5) Post deal

Internal approval and decision-making processes should be taken into account in the process. This requires stringent project management and a detailed schedule (including schedule coordination), through which all stakeholder groups are involved and a legally compliant and competitive process is guaranteed.

External financing in the future

Due to the high investments planned, especially for new construction work, external finance sources continue to play a vital role. PwC sees the trends as follows:

- 1) The significance of the financial markets will increase as a result of greater investment activity over the next few years.
- 2) The plain vanilla bond is currently the type of bond preferred by Swiss hospitals, though other types such as the zero-coupon bond could also become established in future.

- 3) Risk assessments – especially of public sector hospitals – are becoming stricter, which is leading to more restrictive lending.
- 4) Alternative finance sources are gaining in significance. These include donations from the general public, and contributions from patrons or foundations.
- 5) Integrated care models are leading to more and closer strategic partnerships and collaboration. We therefore expect more equity financing.
- 6) One alternative of equity financing is offered through financial investors such as pension funds or private equity investors. They are increasingly active in the healthcare sector. Hybrid financing instruments may also be used in future.
- 7) Innovative, alternative financing instruments may also find their way into the Swiss healthcare sector, including for example asset-backed securities, which are already in use in the USA and Japan. The Initial Coin Offering (ICO) can also be attractive for start-ups in the Swiss healthcare system.

Change is currently on the agenda in the Swiss hospital sector. Many hospitals are planning or are already involved in renovation and new construction projects. Such major projects must be sustainable and financially viable in future. Hospitals are also tackling the issues of structure optimisation, rising patient expectations and new job descriptions. In this rapidly changing healthcare landscape, flexibility in financing as well as in the organisation of hospitals will be a key factor for success in the future.

¹ One exception includes the bonds of the Children's Hospital Zurich which are treated in a similar way to public sector hospital bonds with regard to the Z-spread level.

Changes to the healthcare landscape

New structures, new patient expectations, new job roles – these are some of the important changes to the medical healthcare landscape. The transformation of healthcare can be observed everywhere: with patients, with medical sector players and in new medical technology as well as pharmacological solutions. Vibrancy, focus on competition and economic incentives are features of the Swiss healthcare sector, and will continue to increase pressure in the years to come.

Swiss Healthcare 2030

The healthcare of the future will be far more patient-oriented, team-based and cross-sector. Patients have much greater expectations. New job profiles such as physician assistants, advanced nurse practitioners and others will reshape collaboration between professions in hospitals. Employees with new roles must be deployed to ensure the best impact. Digitisation will also alter roles or even render them redundant, and will create new career profile types. Hospitals must allow a variety of career models and continuous training if they want to retain the loyalty of existing employees and remain attractive to new employees.

Patients: between demographic change and expectations

The demographic trend means that we will see an increase in population overall, as well as a percentage rise of older people in the population. Higher life expectancy and

increased hospitalisation rates of older people go hand in hand with an increase in multimorbid patients.

The age structure of patients, as well as their needs and demands, is constantly changing. Previously, the doctor represented the dominant person in the doctor-patient relationship. Patients today expect to be involved in taking decisions as an equal partner. Doctors need to change their previous “disease group” mindset to think of the patient as an individual in terms of “system-based individualisation”.

Medical technology and IT innovations are ushering in change through progress. The increasingly diverse possibilities in these areas are fuelling changes in the way in which services in the outpatient and inpatient sector are provided, in ways which are noticeable to the patient. For example:

- Continuous monitoring by wearables
- Solutions to the interface problem thanks to innovative IT infrastructure
- Added value of big data and artificial intelligence for successful treatment
- Increasing automation and focus on outpatient services for more efficient treatment



“Efficiency in nursing is vital, which makes the choice of suitable specialists with the right skills even more important”

*Isabelle Lehn,
Director of Nursing CHUV*

Healthcare Provider: Challenge to find skilled employees

A lack of specialists in the medical sector has been forecast in recent years and is now becoming reality. This is expected to become more acute in the medium term up to 2030 due to demographic trends. The reasons for this are diverse and have different roots depending on the job profile. Potential approaches for solving the short to medium-term lack of specialists include:

- **Approach 1:** New job profiles in health professions
- **Approach 2:** Changes to the skill and grade mix in nursing
- **Approach 3:** Staff recruited from overseas
- **Approach 4:** Enhance the appeal of medical professions
- **Approach 5:** Use of technological advances

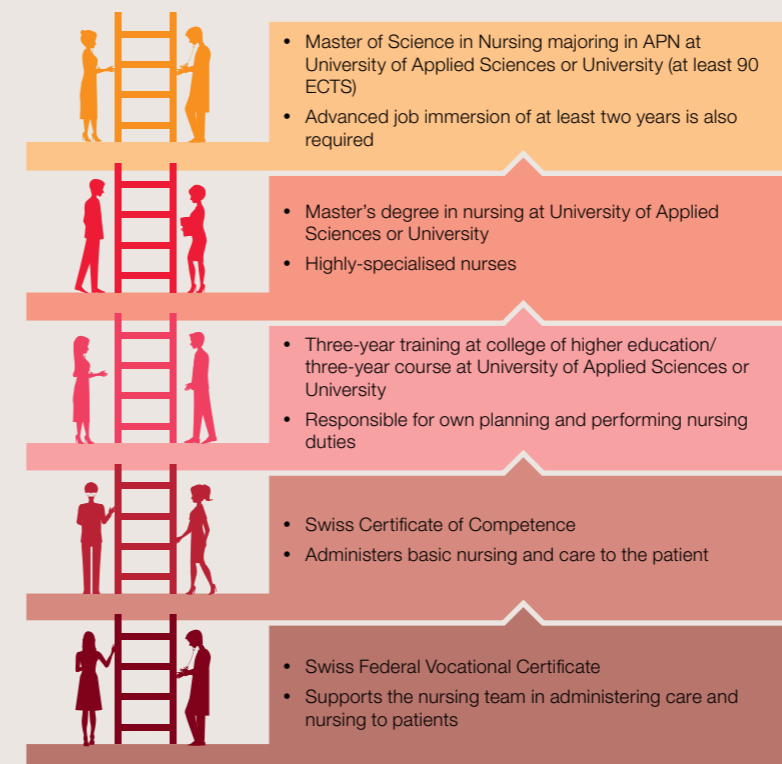
The new roles can be illustrated using the example of nursing, see figure 7.



“Patients today often come with their own devices such as tablets or notebooks, and expect a fully-functional WLAN rather than a TV set”

*Thomas Brack,
Limmattal hospital director*

Figure 7: Role profiles in health professions using the example of nursing



Service provider: new Hub-and Spoke-Models of care delivery

The high number of acute inpatient service providers is cited as a driver of rising health costs in Switzerland. Legislators are looking to intervene with various regulatory measures, for example lowering costs through higher minimum patient number for various interventions, and through case targets for surgical service providers. The trend towards consolidation and, in the long term, centralisation in metropolitan regions will further increase in the next years – as a result, a “Hub-and-Spoke-Model” with an anchor hospital which provides care together with regional hospitals and health centres within a hospital group, might be seen more often.

Along with a reorganisation of the healthcare providers, innovative healthcare provider models and service ranges will appear or gain acceptance. These may include walk-in clinics, Permanence drop-in clinics, clinics in retail stores or expanded Spitex services with increasing specialisation in individual disease groups.

Hospitals can prepare themselves for this future. This should include the creation of a culture that is receptive to change, actively monitors trends and pro-actively addresses key issues. Agility and openness to new ideas are the key to success for anyone who wants to play an important part in shaping this transformation.

“The future pre- and post-treatment business model will run more often via virtual channels and therefore needs to be digitised”

David J. Bosshard,
CEO Clenia Group

More information

The complete study (available in German and French), analyses in interactive format, and detailed information and publications from PwC can be found at www.pwc.ch/hospitalstudy

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“In order to continue developing the various roles in nursing or other healthcare professions, it is important that there are clear definitions and job profiles based on a defined scope of practice. To provide the best possible patient care, it is always about entrusting the right people with the right tasks”

Prof. Dr Rebecca Spirig,
Director of Nursing and MTTB USZ

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