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Espírito Santo Saúde: The Bidding War

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Abstract

Title: Espírito Santo Saúde: The Bidding War

This case study describes the current situation of Espírito Santo Saúde, which involved an eventful takeover process. The company initially went public on February 2014 and later that year, due to the financial situation of its holdings it had to be sold. The bidding war began in August 2014, after Ángeles announced the first offer. Other participants who also pitched bids include José de Mello Saúde, UnitedHealth and Fosun. Furthermore, the potential projects Espírito Santo Saúde was considering implementing prior to the sale and the current situation of the healthcare industry in Portugal, will also be analysed.

Keywords: Acquisition, healthcare, synergies, takeover process

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Espírito Santo Saúde: The Bidding War

August 3, 2014 was an unforgettable day for one of the richest Portuguese families. Banco Espírito Santo (“BES”), which was part of the financial empire built by the Espírito Santo family, was bailed out and split into a good and bad bank, after reporting a net loss in the first half of 2014 of around €3.6bn. In the wake of this event, everything changed. The Group desperately needed to raise money and would consequently sell its most profitable assets, which was the case of Espírito Santo Saúde (“ES Saúde” or “ESS”). See **exhibit 1** with the structure of the Group Espírito Santo (“GES” or “Group”).

Later that month, on a sunny summer day in August, Ángeles, the Mexican group that operated in the healthcare industry, pitched its bid to acquire ESS. The bid marked the beginning of what would become an eventful takeover process lasting around 9 weeks and including several participants. Although the outcome was unpredictable, the high number of companies trying to acquire ESS and the proposal of the Portuguese Communist Party to nationalise the company was proof that ESS was indeed a profitable and attractive company, despite all the problems its holdings were facing.

Espírito Santo Group: The Fall of an Empire

The origins of the group date back to 1869, when the 19-year-old José Maria do Espírito Santo e Silva created a foreign exchange business, where he traded credit securities and lottery tickets. Some decades later, in 1884, he began establishing several other companies dealing with banking operations and securities, one of them that, in the future, would become BES. After José Maria do Espírito Santo e Silva’s death in 1915 BES was managed by his three sons and as from the late 1920s entered into a phase of great expansion. In 1937, BES merged with Banco Comercial de Lisboa. From then on, the bank began expanding and consolidating its position within the banking industry, entered in the insurance business throughout the acquisition of Companhia de Seguros Tranquilidade (“Tranquilidade”) and created several industrial companies. On the 25th

of April 1974, came the Carnation Revolution in Portugal, which was intrinsically related to the nationalisation of the Portuguese banking and insurance sectors in March 1975. As a consequence, many members of the Espírito Santo family were forced to emigrate, mainly to Brazil, the United Kingdom and Switzerland.

By the late 1980s, the Portuguese government invited the family to come back, and following the reprivatisation of the insurance company, Tranquilidade, in 1989, and BES, in 1991, the Group started to rebuild its operations in Portugal, investing not only in the banking and insurance sector but also in the real estate, tourism, communications and other miscellaneous services, through the creation of different companies. Some senior Portuguese business figures postulate that the origins of the family's eventual financial catastrophe lie in this period. The desire of regaining control of the bank was achieved using only a small amount of the family's capital together with huge amount of leverage. "They put in practically zero capital from the start, it was always leverage", said one Lisbon banker¹. In addition, once BES doubled its market share, the family increased its leverage even more to build up interests in other sectors using its stake in the bank as collateral. This situation worsened with the financial crisis that drove Portugal into an international bailout in 2011. The bank was forced to cut dividends and raise new capital, which led to a great decrease of the family's stake in BES. Already, some wondered if and how was possible that BES was able to raise capital in the market when the other Portuguese banks were instead being bailed out by the government. Moreover, some argue it was at this point, due to a lack of access to the market financing, that BES resorted to substitutes for the debt. Regulators started noticing that Rioforte and Espírito Santo International ("ESI") were selling risky short-term commercial papers to the retail and institutional clients of BES, throughout a BES-owned fund, Espírito Santo Liquidez, which raised €1.7bn in debt.

Since ESI was a private company, there was limited information regarding its financial situation. Regardless it is very difficult to hide all of the firm's problems and as the European financial crisis tightened in mid-2013 the family was forced to yet again raise more debt making the market privy of some of the family holdings' problems. Rio Forte disclosed a value of debt equal to €2.9bn, which represented roughly 35x EBIT¹. The CEO of BES, Ricardo Salgado, was aware that something had to be done, or else Rioforte and ESI would eventually default.

¹ Profits before interests and taxes amounted to €84m. Only interest charges were valued at €89m.

In May 2014, BES announced it would perform a capital increase of up to €1.045bn, offering new shares at €0.65. In late May, the market discovered that ESI had hidden €1.2bn liabilities that were unaccounted in its financial statements of 2012. However, the capital increase was successfully completed in June and roughly 1,607 million new ordinary shares were issued².

One month later, in July, just before Rioforte and ESI asked for special protection from its creditors, The Bank of Portugal forced Ricardo Salgado to resign. After this, BES announced its results for the first semester of 2014, revealing a loss of €3.58bn³ and impairments totalling €4.25bn, which consequently led to the family's loss of control of the bank. "As the pressure increased, they allowed the cancer [of ESI] to infect the bank more and more", said a Portuguese banker. "The cancer was in one place, the brain, but they let it spread across the whole body, and to the bank."ⁱⁱ

It was the fall of an empire that took around 150 years to build. From the beginning of June until the end of July, the share price of BES went down 89.11%. On the August 1st, the Portuguese regulator CMVM⁴ suspended the transaction of BES's shares (**Exhibit 2**). The collapse of BES was barely avoided through a rescue package that divided the bank in two. The toxic assets of the bank were split from the good ones, and allocated into a "bad" bank, as an attempt by authorities to rescue what remained of BES. Approximately 15,000 of real estate assets, valued at €2.0bn, were transferred to the "good bank", which was dubbed "Novo Banco", including the participation BES had in Espírito Santo Health Care Investments ("ESHCI"). In October, the court of Luxemburg decided not to give creditor protection to ESI and Rioforte, meaning that both companies would enter in bankruptcy and be liquidated to pay off their debts.

KPMG had been providing audit services to BES since 2002 and was in charge of auditing the financial accounts of more than 60 companies within GES. Both The Bank of Portugal and CMVM believed that a firm should not have the same auditing company for more than two terms, which is the same as to say 8 years. However, in 2011, BES announced the continuation of the bank's relationship with KPMG as it enabled cost savings as well as benefiting from a better service, due to the auditor's knowledge about the Group. Critics blamed KPMG for the bank's demise, defending

² On the June 17th, 2014, BES placed 1,607,033,212 new shares in the market at €0.65 per share, which amounted to a capital increase of €1,044,571,587.8.

³ In the first half of 2014, BES announced a net loss of €3,577.3m, where the net loss of the second quarter amounted to €3,488.1m.

⁴ Comissão do Mercado de Valores Mobiliários ("CMVM") is the Portuguese securities market commission.

that the auditor should have identified the ongoing money transfers between companies within GES. “With the auditor playing so many roles, the question seems to be: Were they just too spread out to see the big picture, or in the worst case were they too focused on getting audit mandates to act on the big picture?”, said a finance professor at London’s Cass Business School, Peter Hahnⁱⁱⁱ.

Unfortunately, this was one of Europe’s largest financial failures, which led investors to losses of approximately €10.0bn. “The fall of the Espírito Santo is effectively the story of Portugal itself,” said one official. “They had too much debt, but they continued to consume^{iv}.”

Espírito Santo Saúde

Overview

One of the Rioforte’s companies that showed evidence of profitability was Espírito Santo Saúde. The company dated back to the acquisition of Clíria – Hospital Privado de Aveiro and Hospital da Arrábida (“HA”), in 2000. Since its creation, ES Saúde has grown both organically and through acquisitions, maintaining a very active strategy in remodelling and expansion projects. In 2007, Hospital da Luz (“HL”) started operating and five years later, the first public hospital managed under a public-private partnership (“PPP”) was inaugurated (**Exhibit 3**).

ES Saúde has a total of eighteen facilities divided into eight private hospitals, one hospital managed under a PPP agreement, seven private outpatient clinics⁵ and two senior residences (**Exhibit 4**). Its hospitals offer several delicate care services, including surgery, inpatient treatment and diagnostic trials, as well as offering services to promote health and avoid diseases, such as check-ups. The outpatient clinics provide services to people who are not in a delicate situation, but need either a diagnosis or therapeutic or ambulatory treatments. The senior residences work as nursing homes and offer rehabilitation and general assistance to elderly patients to provide them an integrated residential solution.

Currently ESS is present in northern, central and south-central Portugal. In some places, ES Saúde owns the only private general hospital and in the two Portuguese regions with the highest purchasing power, Lisbon and Porto, the company has Hospital da Luz, the largest private hospital in Portugal, and Hospital da Arrábida, respectively.

⁵ An outpatient clinic provides services to people that is not hospitalized for 24 hours or more, but who visit a hospital, clinic, or associated facility for diagnosis or treatment.

ES Saúde's strategy relies on differentiation through not only owning the majority of its facilities but also through the completion of recent complete refurbishments of its facilities, which starkly contrasts from those of the National Health System ("NHS").

In early 2012, ESS adopted a different business model entering for the first time into a PPP agreement with the Portuguese government to manage Hospital Beatriz Ângelo ("HBA"). HBA was a newly built facility where ESS managed its operations under the NHS, providing clinical and other medical services⁶. The agreement was reached in December 2009 and HBA began operating gradually in January 2012, having its first full year of operations by 2013⁷ (**Exhibit 5**).

In September 2013, ESS started its Initial Public Offer ("IPO") process, which was successfully terminated in February 2014. The structure involved selling 49% of the capital and keeping 51% under the control of ESHCI⁸. This resulted in total gains of €149.8m, where €22.5m were gains for ES Saúde and the remaining value was gains for the shareholders who sold their position in the company (**Exhibit 6**). ESS was listed on the Lisbon Stock Exchange with a final offer price of €3.20 per share. The company's equity was valued at around €305.7m, which combined with the LTM Net Earnings⁹ of €13.2m, gave a P/E multiple of 23.2x, which was above the average of the European sector at the time. The price range for this IPO had initially been set between €3.20 and €3.90, and the fact that the final offer price (€3.20) had been defined at the lower range¹⁰, together with signals of low demand for ESS shares from its employees, induced investors to be cautious in the initial trading sessions. The day after the IPO, the share price fell 1.25% closing at €3.16 per share. However, by the end of March, the share price had risen 14.7% relative to the initial offer price. In a transaction where Espírito Santo Investment Bank ("ESIB") was the global coordinator¹¹, the main goals

⁶ Those services include outpatient consultations, supply of emergency room visits, both outpatient and inpatient surgeries as well as the provision of non-surgical inpatient and outpatient services (psychiatry, dialysis and chemotherapy services).

⁷ From 2011 to 2012 there was an increase of €2.1m in D&A mainly because this marked the first year that HBA would depreciate.

⁸ The lock-up period was 270 days, but the majority of the agreements included change of control provisions which required ESI to maintain a direct or indirect controlling interest in ESS.

⁹ Last Twelve Months ("LTM") net earnings were computed as the sum of the net earnings of the 1st quarter of 2014 plus the last 3 quarters net earnings of 2013.

¹⁰ The determination of the IPO price corresponded to the last two weeks of January and first week of February, which was a period of increased volatility in the financial markets and a rise in risk aversion on the investors' side, largely as a consequence of instability in some emerging markets.

¹¹ ESIB was the global coordinator of the retail offering. Credit Suisse and ESIB were the joint global coordinators and joint bookrunners of the IPO. Crédit Agricole CIB was senior co-lead manager and Banco Finantia, Banco Santander, BBVA, BPI and CaixaBI were co-lead managers of the institutional offering.

of the IPO were to reinforce ESS's capital structure in order to reduce its leverage, whilst investing in new projects. Additionally, this was seen as a good opportunity to increase visibility worldwide. Notwithstanding, one may question what drove Rioforte to sell part of ESS. Was it a signal of what was already affecting the Espírito Santo Group? In fact, ESS was arguably the only asset of Rioforte that could be set up for an IPO.

The Portuguese Healthcare Industry

The Portuguese public healthcare system is organised so that all citizens have access to the NHS, which is funded through general taxation and co-payments from patients when using the healthcare services¹². However, around 40% of the population benefits from access to other healthcare services, either via an insurance plan or a special public or private plan for specific activity sectors¹³. Since the international financial crisis in 2007, Portugal has faced several unfavourable macroeconomic conditions, which limited the public health system's budget. Gradually, as the investment in this sector decreased, facilities started to deteriorate and there was a migration of the most qualified doctors from the public to the private sector. Moreover, in 2013 the government funding to the state employees' healthcare plans dropped substantially¹⁴ and in 2014 the moderation fees increased. Interestingly, as the public sector expenditures fell, the private sector ramped up its investment.

In 2011, the private sector was responsible for providing around 46% of the total healthcare services, compared to 40% in 2007, which shows it has remained resilient throughout the financial crisis. Moreover, from 2007 to 2011, the revenues of the private healthcare providers¹⁵ increased on average 5.5% per year, while in the public healthcare sector they dropped by an average 0.7% annually. Despite this downward trend, the latter still has an important role in the Portuguese healthcare system, with total revenues in 2011 of €6.5bn, compared to €5.5bn in the private sector^v suggesting that there is room for the private sector to keep growing.

ESS is linked to the public sector through its management of HBA via its PPP agreement, via services provided to patients who are wait-listed in the public sector and

¹² Moderation fees.

¹³ These are public and private health subsystems, where the access depends on their type of work or even their position within the firm. Some plans include ADSE that covers the public workers, SAMS, which is attributable to bankers and LASFA that covers military.

¹⁴ In 2011, government funding was 48%, which slightly increased to 54% in 2012. However, in 2013 it dropped sharply to 29% as a result of financial difficulties faced by Portugal.

¹⁵ Private health revenues include both public and private sources.

via the considerable portion of its revenues that come from state employees' healthcare plans. However, as the majority of its revenues come from the private sector, the deterioration of the public health system may seem to positively affect ESS' financial strength. In an extreme case, the lack of investment may lead to a complete degradation of the NHS, which could force patients to be treated at private hospitals. Recently, the health insurance penetration has been growing, meaning an increasing awareness regarding the competency of private hospitals. Therefore, the aforementioned trends, aided with an ageing population, a higher investment in the private healthcare sector with considerable technological advances in diagnosis and treatment, a boost in the standardization of medical procedures and a greater than ever disease burden, seem to benefit ESS.

ESS's main competitors within Portugal include José de Mello Saúde ("JMS") and ex-Hospitais Privados de Portugal ("HPP"), currently named Lusíadas. All of the aforesaid firms adopted a similar model of a general hospital that provides a complete cycle of services. Considering only the Portuguese private healthcare market, ESS currently has the highest market share and the highest number of beds. However, JMS was the pioneer in implementing PPP agreements and is currently the market leader considering both the private and the public market, followed by ESS. These top three players command approximately 15.5% of the Portuguese private healthcare market share^{vi}, whereas the remainder is distributed in a very fragmented market of private practice offices and small clinics,¹⁶ (**Exhibit 7**) which have been losing market power due to the recent economic crisis that caused some small private healthcare providers to disappear.

Financial Performance

Despite the challenging economic context in Portugal, ESS continued to grow. In 2013, there was an increase of 57% on the revenues coming from the public sector, mainly through capturing HBA's first full year of activity. The increase in cash flow generation allowed ESS to reduce net debt from €251.5m in 2012 to €209.6m in 2013¹⁷.

¹⁶ These small offices mainly provide medical consultations, diagnostic tests and treatment.

¹⁷ In the first quarter of 2014 net debt was €183.1m (debt was €213.9m) and in the first semester of 2014 net debt €184.1m (debt was €206.3m).

In the same year, more than 70% of ESS' private healthcare revenues came from state employees' healthcare plans, such as ADSE¹⁸, military and police forces, as well as from insurance companies. The healthcare plans offered to employees from private companies and out-of-pocket clients together amounted to roughly a quarter (24%) of total private revenues. Additionally, private hospitals often administered certain services on behalf of public hospitals, such as surgeries for patients that have been placed on lengthy waiting lists. In 2013, these services represented 3% of private revenues (**Exhibit 8**).

Since its inception, ESS increased its operational revenues year-on-year. From 2010 to 2013 the revenue compounded annual growth rate ("CAGR") was 14.3%. The private sector represented the major source of ESS revenues, followed by the public sector, then by "holding and shared services"¹⁹ and finally by other businesses, which had a consistent albeit smaller contribution to ESS²⁰ (**Exhibit 9**).

Potential Projects

Before being set up for its sale, ESS was considering the implementation of some projects. Although they had not been adopted by the date of the sale, ESS has an option to implement them, and as a consequence the projects should be considered when valuing ESS.

All the revenues of ESS came from operations located in Portugal and as a consequence they were vulnerable to the country's financial, economic and political changes. The company had been considering expansion and had already designed a plan to expand into Angola²¹, which may represent an effective strategy to diversify its country risk exposure. Moreover, Angola has scarce access to good healthcare services, consisting in an attractive opportunity for ESS to enter into a high growth market, benefiting also from a shared language by both countries. According to local media, the plan was to have ESS in charge of the healthcare management and the local partner would build and maintain the facility. Moreover, the investment was estimated to be

¹⁸ ADSE is a healthcare subsystem integrated in the ministry of finance and public administration, which is responsible for managing the social welfare system of public employees. It allows these workers to attend not only the public hospitals but also to the private hospitals that have an agreement with this subsystem. As of December 2, 2014, the total number of ADSE beneficiaries amounted to 1,274,477.

¹⁹ It provides services common to the "private healthcare" and "other businesses" segments, such as management, consulting, legal and maintenance services.

²⁰ The "private sector" comprises eight general hospital facilities and seven private outpatient clinics. "The public sector" accounts for the revenues coming from HBA. "Holding and shared services" is the corporate centre and "Other businesses", include two senior residences.

²¹ The plan had been designed in collaboration with Teixeira Duarte, the Portuguese construction company due to the firm's considerable expertise in that country.

€100m. Still, one should bear in mind the sustainability of Angola's growth. In fact, it is highly dependent on oil production, whose price has been fallen. Keeping this in mind, Angola is expected to be hit the hardest, with an estimated loss in GDP of approximately 20%^{vii}. Regardless, ESS has an option to open a facility in Angola and benefit from vast networking contacts, but so far no agreement has been reached. Since this is a complex process, ESS cannot predict when the construction may start if an agreement is reached.

Besides the potential international expansion, ESS was also considering the projects of HL and HA²². Regarding the former, ESS was analysing two expansion projects, which were not mutually exclusive. The first involved building a new facility with roughly 6,500 sqm close to the existing one, which will add around 20% of extra capacity to Hospital da Luz. The other, was to add an extra floor to HL representing an expansion of about 5,200 sqm and a 16% rise in capacity. The cost of both projects was estimated to be between €60m and €70m and they were expected to take three years from the decision date to be fully operational²³. Regarding Hospital da Arrábida, ESS was in negotiations to acquire additional space in Arrábida Shopping Centre. The hospital, located in North of Portugal, was the second largest source of revenues for ESS²⁴. Although the additional capacity this project would bring to HA is unknown, its costs were estimated to be between €15m and €25m²⁵. Finally, the fact that ESS owned the majority of its facilities, having only three leased buildings, enabled ESS to go through structural changes when needed, while achieving better financing conditions in the long term comparing with leasing alternatives.

Regarding potential new PPP agreements, there was an ongoing discussion amongst the public that they were unlikely to appear in a near future, as the strategy the Portuguese government had been implementing to reduce its level of debt was based on PPP renegotiation contacts. On the other hand, some supported the hypothesis that the public system had been deteriorating as time goes on and a possible solution to decrease

²² During 2013, the private healthcare segment had a 56% inpatient occupancy rate, while HL and HA accounted for 66% of occupancy, on average, which accounts for both inpatient and consultation's offices' occupancy rate as well as operating rooms' utilization rate. Other facilities such as Hospital Privado, Hospital Santiago, Cliria, Cliria da Amadora, Oeiras and associated outpatient clinics accounted for 42% occupancy rate.

²³ Construction is expected to start in 2015 and be completed in 2018 (3 years of construction).

²⁴ HL represented 44% of ESS' private revenues in 2013 and HA had revenues of €49.5m in 2012. EBITDA margin for HL and HA is higher than ESS' average.

²⁵ The construction period is the same as that of Hospital da Luz.

investment in the healthcare system and make public hospitals more efficient could be the concession of PPP agreements to the private hospitals.

Furthermore, ESS was expecting an answer from the Ministry of Health regarding the right of HBA to receive additional payment for services provided to HIV patients. One of its main competitors, JMS had already received said additional payments in Hospital de Braga since 2013, a hospital that is managed under a PPP agreement. If ESS was able to receive these payments, additional operating revenues of €2.2m for the full year 2014 would be expected.

The Takeover War in a Nutshell

Despite all the problems surrounding GES, ESS apparently cut the financial links it had with troubled companies within the Group. The deposits held at BES were transferred to Novo Banco²⁶ and ESS announced that it did not hold any debt issued by any entity related to GES. However, the beleaguered Espírito Santo family's main holdings were in need of new capital and the sale of ESS became an imminent reality.

ES Saúde has shown over time it has benefited not only from a solid strategy but also from an experienced management team, led by Isabel Vaz, who has been the CEO since the firm's creation. As the news started to spread worldwide, investors from different parts of the globe showed their interest in purchasing ESS. On August 19th, Ángeles, the Mexican private health group, made a public offer to acquire ES Saúde, offering €4.30 per share in cash. Diogo Lucena, the chairman of ESS, promptly reacted defending that although this offer was "acceptable" it did not reflect the potential and intrinsic value of ESS in the long-term. In fact, comparing this offer price with the undisturbed price²⁷ of €3.70, this represented a 16.2% premium, which may be considered relatively low. Moreover, the average EV/EBITDA of previous transactions in the hospital sector for the last three years was 10.3x, indicating that the price Ángeles offered could be low. To some extent, this was understandable since the current situation of GES may have been negatively impacting the bid premium (**Exhibit 10**).

The Mexican Group had acquired 3.32% of the company before the takeover announcement, which resulted in a suspicion from CMVM regarding the possible abuse

²⁶ On August 6th ESS proceeded with an exchange of all of the terminals and payments system. Thus, ATM payments were unavailable and all patients had to pay for the health services either by cash or check. The logic behind this move was to avoid any money going directly to BES. Once at this stage ESS was still waiting from the decision on whether or not it would be moved to the Novo Banco.

²⁷ The undisturbed price is the three-month average (May-July) of ESS share price. This was the period before the news regarding GES started appearing in the Portuguese market.

of privileged information²⁸. The next day, August 20th, Ángeles bought an additional 3.65% stake, bringing their total to 6.97% of ESS. After the first offer had been announced, CMVM declared a counter offer would need to be 2% higher²⁹ than the one already presented by Ángeles. On September 11th, JMS offered €4.40 per share, which represented an increase of 2.33% compared to the first bid. JMS is the healthcare arm of the conglomerate Grupo José de Mello³⁰ and has huge expertise in the private healthcare sector. JMS also manages two PPP agreements and its business structure is very similar with that of ESS. Therefore, the synergies that could appear from having ESS together with JMS are unquestionable.

In response to JMS preliminary offer, Isabel Vaz, CEO of ESS, pointed out some of its potential drawbacks. First of all, the payment to acquire ESS would imply a great deal of leverage, which together with the current financial situation of Grupo José de Mello, could disturb the long-term strategy of ESS. It is also undeniable that as a consequence of the size both companies have in the Portuguese private healthcare sector, some competition issues as well as problems associated with overlapping operations could appear. Moreover, in a statement for its Board of Directors, ESS declared the premiums³¹ paid on takeovers in Europe since 2011 had been on average 32%, and concluded JMS' premium failed to reflect the share of potential synergies (**Exhibit 11**). On the other hand, comparing JMS implicit multiple with those of comparable international peers, it seems the offer is in line as compared to the median EV/EBITDA (**Exhibit 12**).

On September 19th, Ángeles upped its first bid to €4.50 per share, which represented an additional €19m for the total firm's value comparing with the first offer. Nonetheless, at €4.50 Ángeles' offer price was below the €4.70 per share ESS was being traded on that day, meaning investors were still waiting for future bids (**Exhibit**

²⁸ Olegario Vazquez Rana, founder and chairman of the Ángeles and his son Olegario Vázquez Aldir, Managing Director, bought shares of ESS before the announcement of the takeover bid. The market laws defend the information available in the market should be symmetric. In fact, if there is a pending takeover bid, the information possessed by the party intending to buy shares differs significantly from that possessed by the party selling, especially if the buyer is already privy to the upcoming takeover announcement. Actually, after the takeover announcement the share price grew by 9%. Nevertheless, the investigation is still in progress and so far CMVM has not declared whether or not there was in fact abuse of privileged information.

²⁹ The counter offer price would need to be at least €4.386 per share representing a 2% increase compared to the first offer.

³⁰ Grupo José de Mello owns 70% of JMS.

³¹ Premium offered in relation to the pre-announcement closing price in all European business sectors. In 2011 the premium was 38%, in 2012 it was 28%, in 2013 it rose 2% compared to the previous year and in 2014 up to date it is 37%.

13). Indeed, four days later, on September 23rd, Fosun joined the bidding war. The Chinese conglomerate Fosun International bid €451.0m, which translated to a share price of €4.72. Earlier that year, the Chinese group snapped up the Portuguese insurer Caixa Seguros e Saúde³², which includes Fidelidade, for €1bn, signalling its desire to build an international presence. Actually, Fidelidade was the vehicle Fosun used to acquire ESS.

Concerning JMS preliminary offer, some of the foreseen legal problems emerged. JMS's considerable market share in the private healthcare market together with that of ESS could result in market dominance. As a consequence, JMS needed to ask the Competition Authority for their permission to go ahead with the takeover process. With that in mind, JMS asked CMVM to extend the deadline to register a takeover bid, in order to have time to hear from the Competition Authority and then register its offer. However, the deadline imposed by CMVM to register an offer was very tight and the Competition Authority was unable to give its assessment within the period to register a takeover bid. Consequently, on September 25th JMS announced they would be dropping out of the takeover process, blaming the Portuguese regulators for this decision.

On the same day, UnitedHealth Group ("UHG") offered €4.75 per share in an out of the stock exchange deal. UHG is a healthcare company based in United States, which bought HPP. However, instead of pitching the bid directly to ESS, UHG was in negotiations with Rioforte to acquire ESHCI, who owned 51% of ESS. In reaction to this, ESHCI and Rioforte reiterated their availability to sell this participation, but reinforced they would prefer to sell ESS in a more transparent and competitive transaction, such as a sale in the stock exchange. See **exhibit 14** with a more detailed analysis of the companies involved in this bidding war.

On the following day, September 26th, Fosun boosted its bid to €4.82, stepping up again in the battle over ESS. Five days later, on the first of October, Ángeles withdrew its bid. At the time, it had no healthcare businesses in Portugal and as a consequence the synergies from this acquisition would be scarce. The reasoning behind its offer may lie in its aspiration to enter into new markets and the potential for Portugal to be a doorway

³² Caixa Seguros includes five insurance companies, namely Fidelidade, Multicare, Seguros de Saúde, Cares and Companhia de Seguros. It is the insurance arm of the Portuguese State bank, Caixa Geral de Depósitos. With that purchase, Fosun gained the control of around one third of the Portuguese insurance market.

into Europe. However, it is difficult to pinpoint the resultant synergies from this transaction (some possibilities include know-how or expertise).

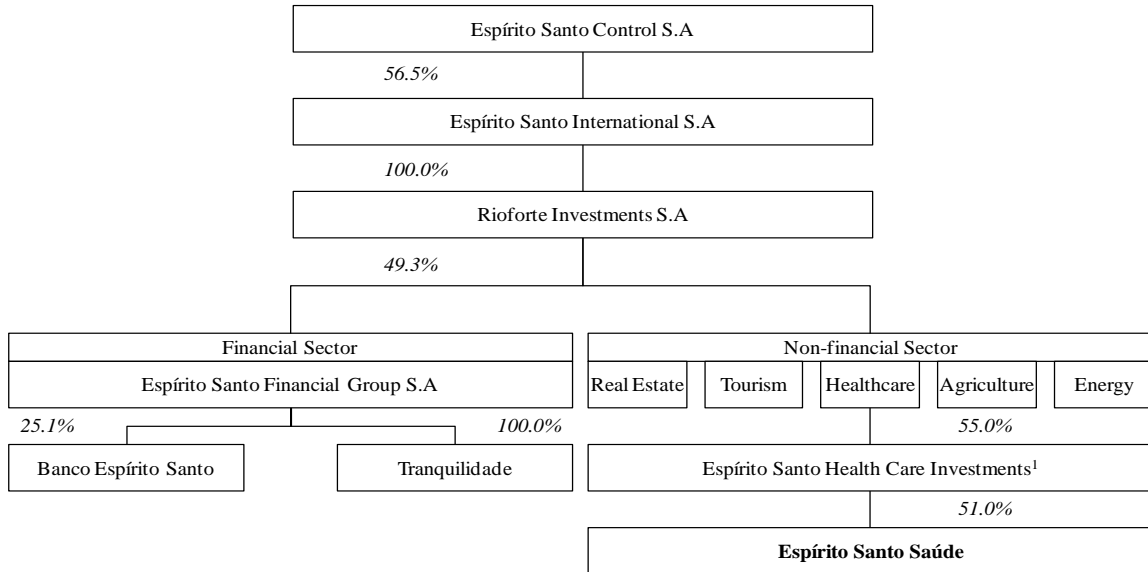
With Ángeles and JMS already out of the bidding war, the battle for ESS was winding down. Nonetheless, 6 days after Ángeles announced it was out of the process, UHG outbid Fosun's offer and launched €5.00 per share, for 51% of ESS. Once again, the bid was pitched directly to the parent company of ESS. In fact, it is hard to understand why UHG adopted this strategy as in most cases, while a takeover bid exists, all offers need to be public, which was not the case of UHG's bid. Fosun defended UHG should have followed the rules of competitive offerings, namely the registration of the bid in CMVM up to the 3rd of October. However, on October 9th, Fosun raised its bid to €5.01, while declaring they considered the offer launched by UnitedHealth to be illegal and defending that the deadline to make an offer had already past. That same day, CMVM announced they considered UnitedHealth's offer to be illegal (**Exhibit 15**).

Fosun's goal of building a long-term project favoured the firm in the acquisitions of both Fidelidade and ESS. Additionally, one of the characteristics of insurance companies is their ability to generate cash flows, which in the particular case of Fidelidade meant that Fosun would not need to ask for external financing to acquire ESS. Moreover, in September 2014, GES officially announced that it had sold Tranquilidade to Apollo. Tranquilidade and ESS derived many advantages from belonging to the same group (GES) since currently insurance companies are one of the major sources of revenues for private hospitals. Therefore, this represented another advantage Fosun had compared to the other candidates. ESS lost its coalition with Tranquilidade, but through its acquisition by Fosun, would form a new coalition with Fidelidade.

On October 15th, there was a special session to discuss Fidelidade's offer. Two days after this session, the bidding war finally came to an end, with Fosun paying €459.5m for 96% stake in the Portuguese healthcare company. 73 days after the collapse of BES, Rioforte's crown jewel became a Chinese corporation.

Appendices

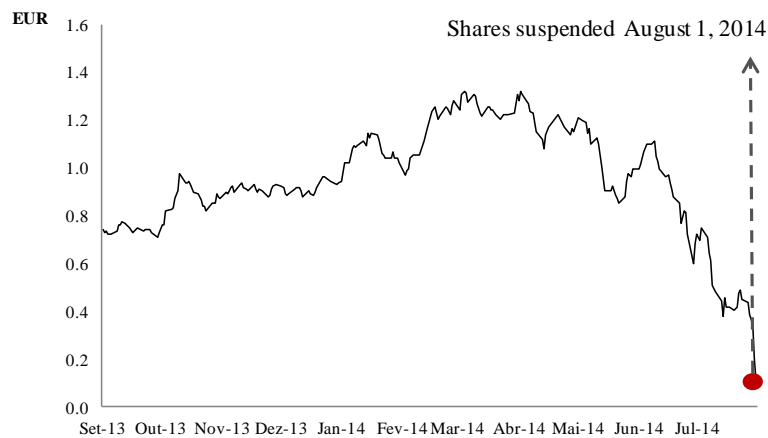
Exhibit 1 Organisation of the Espírito Santo Group



Source: Jornal de Negócios, as of July 10, 2014 and Jornal Expresso, as of October 11, 2014.

Note: [1] Espírito Santo Health Care Investments is owned by Espírito Santo Financial Group (17.7%); Rioforte (55.0%) and Novo Banco (27.3%). Moreover, BES (18.2%) and BES Vida (9.1%) shares have been transferred to Novo Banco.

Exhibit 2 Banco Espírito Santo share price evolution



Source: Bloomberg, as of September 15th, 2014.

Exhibit 3 History and milestones of ES Saúde

- 2000:** Acquired a majority stake in Cliria - Hospital Privado and in Hospital da Arrábida
- 2002:** Started managing the Hospital da Misericórdia de Évora
- 2003:** Started the construction of the Luz Integrated Health Complex (including both Hospital da Luz and Casas da Cidade- Residências Sénior)
- 2004:** Cliria - Centro Médico de Águeda started operating and Clube de Repouso da Casa dos Leões was integrated into ES Saúde
- 2005:** Started the construction of Hospital da Luz – Clínica de Oeiras
- 2006:** Hospital do Mar opened; Acquired 100% of IRIO – Instituto de Radioterapia and Hospor¹
- 2007:** Hospital da Luz and Hospital da Luz – Clínica de Oeiras started operating
- 2008:** Hospital of Santiago renewed one of its inpatient floors

Exhibit 3 History and milestones of ES Saúde (continuation)

2009: Casas da Cidade – Residências Sénior and Hospital da Luz – Centro Clínico da Amadora opened; Clíria – Clínica de Oiã was bought; a PPP for Hospital Beatriz Ângelo was signed

2010: Hospital da Arrábida, Cliria – Hospital Privado, Clipóvoa – Hospital Privado and Hospital de Santiago were renovated

2011: Great focus on Hospital Beatriz Ângelo; Hospital da Luz and Hospital de Santiago underwent renovations

2012: Hospital Beatriz Ângelo started operating; Hospital do Mar, Cliria – Clínica de Oiã, and Hospital de Santiago was remodeled

2013: Expansion of Hospital do Mar and the renewal process of Cliria – Clínica de Oiã and Hospital de Santiago were completed

Source: Company data.

Note: [1] Include Hospital de Santiago in Setúbal and Clipóvoa, Hospital Privado in Póvoa do Varzim, Clínica de Cerveira, Clínica de Amarante and Clínica do Porto.

Exhibit 4 Espírito Santo Saúde's facilities

Hospitals	Location
Clipóvoa - Hospital Privado	Póvoa do Varzim
Cliria - Clínica de Oiã	Oiã
Cliria - Hospital Privado	Aveiro
Hospital Beatriz Ângelo	Loures
Hospital da Arrábida	Porto
Hospital da Luz	Lisbon
Hospital da Misericórdia de Evora	Evora
Hospital do Mar	Sacavém
Hospital de Santiago	Setúbal
Clinics	Location
Clipóvoa - Clínica de Amarante	Amarante
Clipóvoa - Clínica de Cerveira	Vila Nova de Cerveira
Clipóvoa - Clínica do Porto	Porto
Cliria - Centro Médico de Agueda	Agueda
Hospital da Luz - Centro Clínico da Amadora	Lisbon
Hospital da Luz - Clínica de Oerias	Oerias
IRIO - Instituto de Radioterapia	Lisbon
Senior residences	Location
Casas da Cidade - Residências Sénior	Lisbon
Clube de Repouso Casa dos Leões	Carnaxide

Source: Company data

Exhibit 5 Details of the PPP agreement of Hospital Beatriz Ângelo

Through SGHL – Sociedade Gestora do Hospital de Loures, ESS manages the PPP agreement of HBA. The prices that HBA charges to the NHS patients are contractually agreed and adjusted annually based on the inflation rate¹. The initial term was agreed to be 12 years, including a 2 year construction period and 10 years of operations, starting on HBA's opening in 2012. Moreover, the contract can be extended for two 10-years terms, but the entire duration of the contract cannot exceed 30 years from December 2009. Additionally, ESS has a 10% stake on HL – Sociedade Gestora do Edifício, which was responsible for the construction but also is in charge of maintaining, conserving and managing the hospital's facilities and building. SGHL, which is 100% owned by ESS, is in charge of HBA's operational management and HL manages the building under a 30 year contract.

Source: Company data and Flores, João, June 2014, "ES Saúde in good shape", *Millenium Equity Research*

Note: [1] Long term inflation rate is expected to be 1%

Exhibit 6 ESS shareholders structure before and after the IPO

At the time of prospectus, January 2014	# Shares	Economic Stake
Companhia de Seguros Tranquilidade	2,655,000	3.00%
Espírito Santo Financial Group	13,384,053	15.12%
Rio Forte Investments	23,734,397	26.82%
Espírito Santo Health Care Investments	48,726,550	55.06%
Free float	0	0.00%
Total	88,500,000	100.00%
As of June 2014	# Shares	Economic Stake
Espírito Santo Health Care Investments	48,726,550	51.00%
Santander Asset Management	4,934,045	5.16%
Invesco Limited	4,771,188	4.99%
T. Rowe Price	4,790,000	5.01%
Och-Ziff Capital Management LLC	4,175,196	4.37%
HSBC Holdings	3,876,307	4.06%
Espírito Santo Financial Group	3,228,283	3.38%
Fidelity International Limited	2,800,000	2.93%
Fidelity Management Research	2,500,000	2.62%
Stakes below 2%	15,740,685	16.48%
Total	95,542,254	100.00%

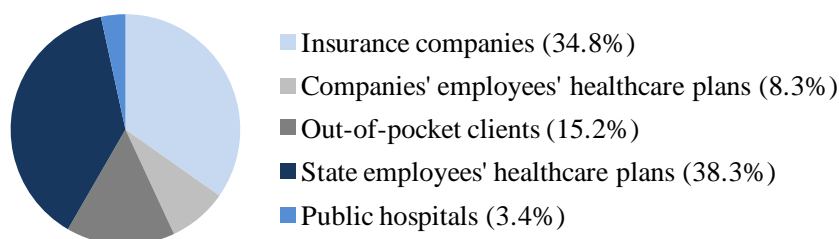
Source: ESS prospectus and company data

Exhibit 7 Market share in the private hospital market, by region

Private hospital beds	Portugal	ESS	JMS	HPP
North	3,325	311	144	138
Center	1,081	0	0	0
Lisbon	3,837	306	320	180
Rest of the Country	2,174	138	0	79
Total	10,417	755	464	397

Source: Company data and Portuguese INE data as of 2011

Exhibit 8 ES Saúde's private healthcare revenues, in 2013, by type of payers



Source: Company data

Exhibit 9 ES Saúde's financial statements

a) Income statement (Quarterly)

EURm	2013				2014	
	3M	6M	9M	12M	3M	6M
Operating revenue	93.5	188.9	279.5	373.6	101.6	201.1
EBITDA	13.4	28.0	43.1	59.0	15.4	28.3
EBIT	6.3	13.9	22.1	30.9	8.4	14.6
EBT	3.3	8.3	14.0	20.5	6.4	10.8
Net income	2.3	6.0	9.1	14.0	4.6	8.7

Source: Company data

b) Income statement

EURm	2010	2011	2012	2013
Operating revenue	250.2	273.6	341.4	373.6
Private Healthcare	247.0	271.0	286.3	288.8
Public Healthcare	0.0	0.0	52.2	82.1
Other Businesses	3.0	3.0	2.9	3.5
Corporate Center	n.a	5.0	5.0	12.2
Adjustments	n.a	(5.4)	(5.0)	(13.0)
Operating costs	(212.7)	(227.2)	(302.6)	(314.6)
EBITDA	37.5	46.4	38.8	59.0
Private Healthcare	n.a	57.5	51.8	58.5
Public Healthcare	n.a	(3.5)	(11.7)	1.1
Other Businesses	n.a	(0.5)	(0.3)	0.2
Corporate Center	n.a	(7.1)	(1.0)	(0.8)
D&A	(26.5)	(26.4)	(28.5)	(28.1)
Private Healthcare	n.a	n.a	(23.2)	(21.6)
Public Healthcare	n.a	n.a	(3.9)	(5.3)
Other Businesses	n.a	n.a	(1.4)	(1.3)
EBIT	11.0	20.0	10.3	30.9
Interests	(8.4)	(11.1)	(12.4)	(10.4)
EBT	2.6	8.9	(2.1)	20.5
Taxes ¹	(1.2)	(4.1)	0.0	(6.5)
Net Income	1.4	4.8	(2.1)	14.0

Source: Company data and Flores, João, June 2014, “ES Saúde in good shape”, *Millenium Equity Research*

Note: [1] ESS corporate tax rate is 29% (25% + municipal and national surtax charges)

[2] ESS expected effective tax rate is 29.7%

c) Balance Sheet

EURm	2010	2011	2012	2013
Property, plant and equipment	292.1	272.5	271.2	253.9
Intangible assets	94.6	94.6	94.6	95.7
Others	0.1	0.9	1.8	1.5
Total non-current assets	434.0	368.0	367.6	351.2
Inventories	5.5	5.4	7.9	7.4
Trade receivables	77.5	64.1	71.3	50.9
Other receivables	18.8	68.8	20.7	33.5
Current tax receivables	0.7	1.0	1.1	0.3
Cash and cash equivalents	11.0	33.3	24.3	34.8
Total current assets	113.4	172.7	125.2	126.7
Total assets	547.4	540.6	492.8	477.8
Share capital	88.5	88.5	88.5	88.5
Share premiums	81.6	47.7	47.7	47.7
Non-distributable reserves	0.0	0.0	0.1	1.0
Distributable reserves	0.0	0.0	2.2	18.6
Retained earnings/(losses)	(45.9)	(10.6)	(9.0)	(28.2)
Net income/(loss) attributable to equity holders of the parent	1.5	5.0	(2.1)	14.0
Shareholders' equity attributable to non-controlling interests	0.8	1.4	1.5	1.5
Total shareholders' equity	126.5	132.0	128.9	143.2
Provisions for risks and charges	3.4	4.0	5.6	7.9
Trade payables	0.0	0.0	0.0	0.7

c) Balance Sheet (continuation)

EURm	2010	2011	2012	2013
Non-current bank liabilities	239.0	289.9	144.7	139.9
Finance lease liabilities	31.7	23.0	35.9	27.4
Deferred tax liabilities	0.1	2.9	0.2	0.6
Total non-current liabilities	274.2	319.7	186.5	176.5
Trade payables	27.0	20.1	29.1	23.6
Other payables	39.0	42.4	52.5	54.6
Current bank liabilities	69.0	15.5	83.9	66.1
Tax payable	0.5	1.0	0.7	2.7
Finance lease liabilities	11.3	9.9	11.3	11.1
Total current liabilities	146.7	88.9	177.4	158.1
Total liabilities	421.0	408.6	363.8	334.5
Total shareholders' equity and liabilities	547.4	540.6	492.8	477.8

Source: Company data

d) Other financial data

EURm	2010	2011	2012	2013
Net Working Capital ¹	32.0	67.6	11.4	0.8
Capital expenditures	(23.6)	(7.5)	(32.5)	(12.5)
Private Healthcare	n.a	n.a	(6.9)	(8.3)
Public Healthcare	n.a	n.a	(25.4)	(2.5)
Other Businesses	n.a	n.a	(0.2)	(1.7)
Total debt	351.1	338.2	275.8	244.4

Source: Company data

Note: [1] On the first half of 2014, NWC was €10.8m

Exhibit 10 Previous transactions in the healthcare sector

Acquirer	Target	Announcement date	Deal value (LTM)		
			Revenue	EBITDA	EBIT
Duke Street	Voyage Care	06-08-2014	1.9x	9.3x	17.4x
Nordic	GHD GesundHeits	19-06-2014	1.0x	9.4x	n.a.
Acadia	Partnerships in Care	03-06-2014	2.3x	8.8x	11.8x
Ramsay	Medipsy	29-11-2013	1.0x	7.6x	n.a.
Doughty Hanson	Teknon	04-10-2013	n.a.	13.0x	n.a.
Fresenius	Rhoen Klinikum	13-09-2013	1.5x	12.3x	n.a.
EQT	Terveystalo	10-09-2013	1.4x	12.4x	n.a.
Bridgepoint	Oasis	02-04-2013	1.3x	9.0x	n.a.
Bupa	Lux Med	21-12-2012	n.a.	n.a.	n.a.
Mediclinic	Emirates Healthcare	27-08-2012	2.0x	10.6x	14.7x
Terra Firma	Four seasons Health Care	30-04-2012	n.a.	8.2x	n.a.
Doughty Hanson	Grupo Hospitalario Quirón	09-02-2012	1.0x	10.4x	n.a.
Fresenius SE	Rhön-Klinikum	26-04-2012	1.5x	11.2x	18.4x
Fresenius	Rhoen Klinikum	26-04-2012	1.5x	10.9x	16.5x
Doughty Hanson	USP Hospitales	09-02-2012	1.0x	10.4x	n.a.
Average			1.5x	10.3x	15.8x
Median			1.5x	10.4x	16.5x

Source: Bloomberg, company data and Lowi, Ricardo, Walton, Jo, Weston, Matthew, August 2014, "Week 2Q, focus on M&A", *Credit Suisse Equity Research*

Exhibit 11 Market information

Market data

10y German Government Bond ¹	1.32%
10y Portuguese Government Bond ¹	3.62%
10y US Government Bond ¹	2.56%
Market risk premium ²	6.00%

Source: Bloomberg and Damodaran, Aswath, 2014, *Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2014 Edition*

Note: [1] GSPT10YR, GDBR10 and USGG10YR indexes average rate from May 2014 to July 2014

[2] Historical market risk premium by Mckinsey & Company and Damodaran, Aswath

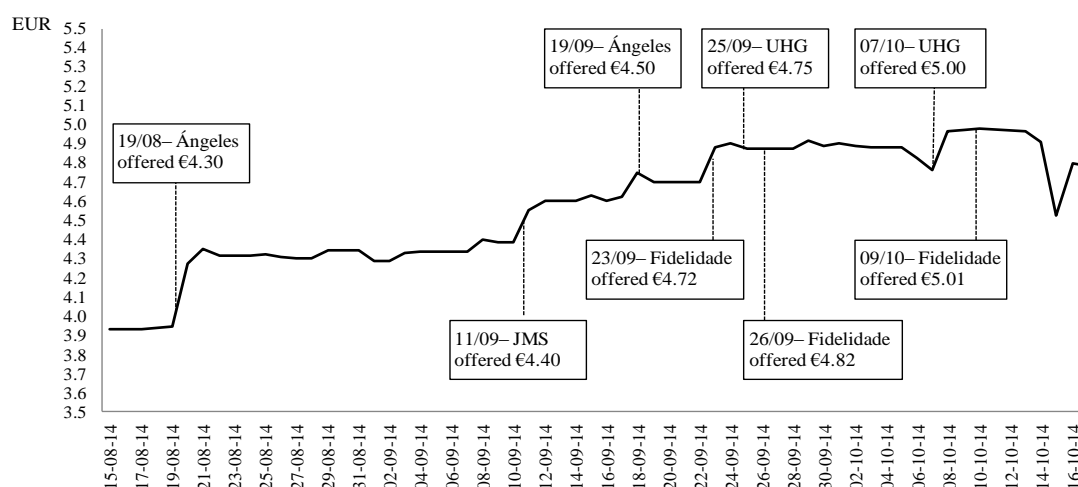
Exhibit 12 Multiples from comparable listed peers of ES Saúde

Company	Country	Market cap (€k)	EV/EBITDA			P/E		
			2014E	2015E	2016E	2014E	2015E	2016E
Spire	UK	1,444	10.2x	9.3x	8.3x	n/a	n/a	n/a
Orpea	France	2,808	13.2x	11.5x	10.4x	21.0x	18.4x	16.2x
Korian-Medica	France	2,354	11.3x	9.6x	8.5x	22.7x	17.1x	15.0x
Fresenius	Germany	20,820	8.4x	7.4x	6.5x	18.4x	16.0x	14.0x
Rhoen Klinikum	Germany	3,276	9.7x	7.8x	n/a	45.0x	26.9x	22.6x
Ramsay Healthcare	Australia	7,024	16.1x	13.3x	11.1x	30.8x	25.9x	22.7x
Netcare	South Africa	3,397	12.3x	10.5x	9.2x	20.3x	17.3x	14.7x
Mediclinic	South Africa	5,746	16.7x	14.2x	12.7x	26.4x	21.6x	19.1x
Life Healthcare	South Africa	3,415	13.7x	12.1x	10.6x	22.9x	22.0x	19.1x
HCA holdings	USA	24,731	8.5x	7.8x	7.0x	17.5x	15.5x	13.6x
LifePoint	USA	2,595	8.8x	7.7x	7.0x	23.9x	20.7x	18.2x
Universal HS	USA	8,795	9.8x	8.9x	8.0x	19.8x	18.0x	16.1x
Community HS	USA	5,168	8.0x	7.0x	6.4x	21.6x	16.6x	14.2x
Tenet Healthcare	USA	4,822	8.7x	7.5x	6.9x	52.4x	25.7x	19.2x
Median			10.0x	9.1x	8.3x	22.7x	18.4x	16.2x
Average			11.1x	9.6x	8.7x	26.4x	20.1x	17.3x

Source: Company data, Bloomberg as of September 22, 2014 and ESS Board of Directors Statement regarding the opportunity and conditions of José de Mello Saúde, S.A. Offer, 24 September 2014

Note: [1] The unlevered beta for the healthcare sector was 0.85 from Flores, João, June 2014, “ES Saúde in good shape”, *Millenium Equity Research*

Exhibit 13 ESS share price evolution during the bidding war



Source: Company data

Note: On the 30th of July 2014, the share price closed at €3.7

Exhibit 14 Profile of the different interveners in the bidding war

Ángeles Health is Mexico's largest private hospital network. The company specialises in high value medical tourism and has 23 hospitals comprising more than 2,000 beds and 200 operating rooms. Annually, around five million patients are treated by 11,000 physicians.

Fosun is a conglomerate that operates beyond insurance, having activities in steel, real estate, pharmaceuticals, healthcare, mines and asset management. Guo Guangchang, president and founder of Fosun, is the tenth richest in China and is known as the Chinese Warren Buffet.

José de Mello Saúde has fifteen facilities including private hospitals, public hospitals under PPP agreements, clinics and living and home services for the elderly. For many years it was a reference in the private healthcare industry, owning one of the biggest private hospitals in Portugal, CUF das Descobertas. It was the pioneer in PPP agreements undergoing its first in 1995 through the management of Hospital Fernando de Fonseca (Hospital Amadora-Sintra). This agreement ended in 2009 and the government started managing it. Currently it has two PPP agreements with Hospital de Vila Franca de Xira and Hospital de Braga.

UnitedHealth is by far the largest and most diversified healthcare company in the United States, serving more than 85 million people worldwide. The American group acquired Amil Participações, Brazil's largest health insurer and hospital operator in 2012. In late 2012, Amil bought Hospitais Privados de Portugal, currently designated as Lusíadas, from Caixa Seguros e Saúde. In Portugal, UHG manages assets such as Hospital dos Lusíadas and the PPP agreement with Hospital de Cascais.

Source: Company data

Exhibit 15 CMVM announcement regarding the UnitedHealth offer

The Executive Board of the CMVM (*Comissão do Mercado de Valores Mobiliários*) states that on this date, UnitedHealth Group Incorporated ("UHG") has been instructed to remove the proposal submitted to *Espírito Santo Health Care Investment SA* and to refrain from acting, disclosing or circulating any acts relating thereto, besides the communication regarding this withdrawal, pursuant to Article 185/1 and Article 360/1/f) of the Securities Code.

Said instruction is based on the disruption of a takeover bid underway on the shares representing the capital of *Espírito Santo Saúde, SGPS, SA* ("ESS") due to nonconformity with the legal framework concerning competing takeover bids.

As such: a) UHG's proposal was announced after the registration of takeover bid underway, launched by *Fidelidade - Companhia de Seguros, SA* ("Fidelidade"); b) It was announced at a time when it could not be formulated as a competing bid, given the period in which such an offer should be launched under Article 185-A/1 of the Securities Code; c) It aims to acquire a 51% stake in the share capital of ESS - equivalent to the minimum amount that Fidelidade proposes to acquire and that is a condition for its bid success - and immediately after, the acquisition of the entire capital of ESS - equivalent to the maximum amount that Fidelidade proposes to acquire via its public offer; d) Although this proposal has been formally addressed to the majority shareholder of ESS, it was publicly disclosed in such a way that it constrained the will-formation of the other ESS shareholders that should be enlightened and informed; e) Thus, UHG is factually competing with the takeover bid launched by Fidelidade, including among all potential recipients (indirect) of its proposal, all shareholders of that company, holders of shares that would be targeted by a takeover bid that UHG should launch if its proposal were to be accepted by ESHC; f) Due to the abovementioned reason, UHG's conduct does not conform with the rules for competitive bids, under Articles 185 and following of the Securities Code, inasmuch as a transaction occurs simultaneously with the ongoing takeover bid, thus formally constituting a different legal type of public offer, nevertheless involving the public disclosure of an intention to obtain the same number of shares that is the subject of same.

Source: CMVM as of 9 of October 2014

Teaching Notes

The sale of ESS is inherently related to the demise of the Espírito Santo family empire. Thus, it is important to understand that although the company has proved to be profitable, the problems surrounding its holdings resulted in its sale. Consequently, when analyzing the value of ESS one should look at the environment in which the company operates and the changes suffered. The discussion of the case should also include the choice of the best possible candidate to acquire ESS and the synergies that each bidder could have. Moreover, the future of the private healthcare industry should be carefully analysed, as well as the potential projects the company may decide to implement. Proposed questions and solutions can be found below.

1. What was the reasoning behind the IPO of ESS? Why was the price set at the minimum range?

The problems surrounding the Espírito Santo holdings were starting to spread throughout all the other arms of the Group. In ESI's financial statements for 2012, around €1.2bn in liabilities were not accounted for, which is strong evidence that by that time a problem already existed. Since Rioforte was related to ESI, those problems were also affecting Rioforte which needed to raise capital. ESS was performing extremely well and represented one of Rioforte's most valuable assets. Before being set up for an IPO, ESS was wholly owned by companies of GES. The idea was to spread a minority stake of 49% and through this guarantee that control of the ESS was maintained, while also creating an opportunity to raise a considerable amount of capital. After the book building process has been completed, the IPO price was set at the lower range, €3.20, which was a result of an increase in volatility in the financial markets and a rise in investor risk-aversion, largely as a consequence of instability in some emerging markets. Additionally, employee demand for ESS's shares was very low, which caused investors to be cautious. Finally, this was a sale of a 49% minority stake, which generally has a discount higher than those IPOs entailing the transference of control.

2. Why had UnitedHealth decided to pitch its bid directly to the parent company?

The strategy UHG adopted is very difficult to understand and was subsequently considered to be illegal from CMVM. Its goal was apparently to pitch the bid directly to the owners (ESHCI) of the 51% majority stake of ESS. However, UHG did not publicly launch the offer under the rules of competitive offering, which state that the registration

of the bid should have been done until the 3rd of October and should have been public. Apparently, it seems that UnitedHealth was attempting to acquire the 51% stake of ESS and then negotiate the acquisition of the remaining 49% stake at a lower price.

3. In your opinion which candidate was in a better position to acquire ESS?

When analysing the possible buyers of ESS one should consider the potential synergies resulting from this acquisition. Ángeles has no healthcare businesses in Portugal and although it has shown its desire to acquire ESS, even before the collapse of BES, it is difficult to find significant synergies from having Ángeles managing ESS. On the other hand, JMS was probably the bidder that stood to benefit the most since it is one of ESS main competitors. However, the deal meant that it would face several problems regarding competition, which could lead to redundancies and to the closure of some hospitals. In addition, the holding of JMS is already heavily indebted, which alarmed Isabel Vaz and went against ESS' strategy thus far. Regarding UnitedHealth, the strategy it adopted is unclear. Currently, the group owns Lusíadas in Portugal, which together with JMS are ESS' main competitors. Thus, it would benefit from having both companies together, although it would probably also run into some competition problems, namely for having two hospitals in the same street. Finally, Fosun has acquired Fidelidade and gained the control of one third of the Portuguese Insurance market. It is unquestionable that having insurance companies together with private healthcare firms is a huge advantage, since nowadays insurance companies represent one of the main sources of revenues for private hospitals. Before the collapse of BES, ESS and Tranquilidade were part of the same group and ESS benefitted significantly from this. Having said this, Fosun's acquisition of ESS, would pair up the healthcare provider with an insurance company again, bringing benefits to both companies. As a consequence, Fosun would stand to gain large synergies and would be the bidder in the best position to raise the price to the highest level.

4. Was the price Fosun paid to acquire ESS reasonable?

In order to analyse whether or not the price paid by Fosun was fair, one should look to different valuation metrics. When using multiples to value a company it is very important to find very similar companies as there are many factors that may distort the value of a firm. The main Portuguese competitors of ESS are not listed and as a consequence cannot be used. Since it is very different to analyse a hospital in Portugal from one operating in a different country, one should conclude there are no players that

are 100% similar to ESS³³. As a result, one should use a wide range of multiples to find a better comparison with ESS. Using the median EV/EBITDA for all the trading multiples (10.0x) one obtains an EV of €593.0m, using LTM EBITDA of €59.3m, which was computed as the EBITDA of the second half of 2013 plus the one from the first half of 2014 ($€31.0m + €28.3m = €59.3m$). Regarding precedent transaction multiples, the exhibit 10 presents a table which shows that the average EV/LTM EBITDA was equal to 10.3x, which together with a ESS's LTM EBITDA of €59.3m, gives an EV of €610.8m. The price paid by Fosun was €5.01, which implies an equity value of €478.7m ($price\ per\ share * number\ of\ shares \Leftrightarrow €5.01 * 95.542m$). In order to obtain the enterprise value³⁴ it is necessary to add the net debt of the first half of 2014, which was equal to €184.1m ($EV = €478.7m + €184.1m = €662.8m$). This translates into an EV/LTM EBITDA multiple for the transaction of 11.2x ($EV/LTM\ EBITDA \Leftrightarrow €662.8m/€59.3m$), which was higher than the average of previous transactions and current trading peers multiples.

Concerning the DCF analysis, it is critical to understand and to account for ESS' option to enter into different projects: The expansion of HL, HA and the opening of a hospital in Luanda. The latter is the less likely project as an agreement has yet to be reached and Angola is witnessing several problems deriving from the recent drop in oil prices, which has an immense impact on its GDP. Moreover, there is no information about the dimension of the hospital and there is only an estimated cost reported from local media in Angola. Thus, in the following valuation, the option of opening a hospital in Angola was not considered since its value would be very close to 0. On the other hand, both the expansion of HL and HA were considered and having the projects implemented was deemed probable. HL has two non-mutually exclusive projects that will add 36% ($20\% + 16\%$) extra capacity to the existing hospital. The information provided stipulates that in 2013, 44% of private revenues came from HL, which means that in 2013 the hospital had revenues of €127.1m ($44\% * €288.8m$). No information regarding EBITDA is provided but since this hospital has an EBITDA margin higher than the average of the group, it was assumed that HL accounted for 50% of private EBITDA in 2013, meaning €29.3m ($50\% * €58.5m$). D&A and capex, were assumed to be 20% of ESS' total depreciation and maintenance capex in 2013, respectively €5.6m

³³ Furthermore, the European healthcare industry is characterised by the broad healthcare services provided by the state. On the other hand, companies from US use more leverage in their capital structure.

³⁴ Enterprise value was computed as the sum of equity with net debt.

and €1.5m. Using an effective tax rate of 29.7%, the NOPLAT was computed to be €16.6m ($EBIT * (1 - \text{effective tax rate}) \Leftrightarrow €23.6m * (1 - 29.7\%)$). From 2010 to 2013, the NWC was very unpredictable, which may be due to the timing of ADSE payments to the private hospitals. However, once there is no information discriminated by hospital, HL's NWC was assumed to be very close to €0 for all the considering period. With this, the FCF in 2013 amounted to €20.8m. Thus, in order to value the incremental FCF of the project, one should compute the FCFs for the remaining years and then sum all the discounted incremental FCFs. The project will enter its constructing phase in 2015, which will be concluded in 2018. The total capex was estimated to be €65.0m spread equally from 2015 to 2017. Upon completion, 2018 will have an increase in revenues by $36\% * 66\%$, which is the current occupancy rate of HL, (*i.e.* $HL\ 2018\ revenue = HL\ 2013\ revenue * (\text{extra capacity} * \text{current occupancy rate} + 1) \Leftrightarrow €127.1m * (36\% * 66\% + 1) = €157.3m$). Following the same reasoning and expecting EBITDA³⁵ to increase 40%, HL 2018 EBITDA will equal €37.0m ($HL\ 2018\ EBITDA = HL\ 2013\ EBITDA * [(\text{extra capacity} + 4\%) * \text{current occupancy rate} + 1] \Leftrightarrow €29.3m * [(36\% + 4\%) * 66\% + 1] = €37.0m$). In that same year, the depreciation is expected to be that of 2013 (€5.6m) plus $4\% * HL\ 2018\ revenue$ ($2018\ HL\ total\ D\&A = €11.9m$). The probability that ESS will undergo this project was assumed to be 80%. See **Teaching Notes (“TN”) Exhibit 1**.

TN Exhibit 1 HL's project - Incremental data relative to 2013

EURm	2014	2015	2016	2017	2018	Terminal value
ΔOperating revenue	0.0	0.0	0.0	0.0	30.2	
ΔEBITDA	0.0	0.0	0.0	0.0	7.7	
ΔD&A	0.0	0.0	0.0	0.0	(6.3)	
ΔEBIT	0.0	0.0	0.0	0.0	1.4	
ΔTaxes	0.0	0.0	0.0	0.0	(0.4)	
ΔNOPLAT	0.0	0.0	0.0	0.0	1.0	
ΔCAPEX	0.0	(21.7)	(21.7)	(21.7)	(0.1)	
ΔChanges NWC	0.0	0.0	0.0	0.0	0.0	
ΔD&A	0.0	0.0	0.0	0.0	6.3	
ΔFree Cash Flow	0.0	(21.7)	(21.7)	(21.7)	7.2	112.7
Discounted FCF	0.0	(20.0)	(18.5)	(17.0)	5.2	75.5
Sum PV future FCF		25.2				
Probability		20.2				

The valuation of HA's project has a similar approach to that of HL. The case states that in 2012, HA had revenues of €49.5m, which represented 17% of private revenues ($€49.5m/€286.3m$). This percentage was assumed to have stayed constant in 2013. However, since the extra capacity was not provided within the case, it was estimated to be 22%, comparing the total capex of €20m with that of HL's project and assuming that HL's construction will be more expensive. The EBITDA was expected to increase by

³⁵EBITDA is expected to increase more than revenues once EBITDA margin of HL is higher than the average of ESS.

27%, for the same reason as in HL's project. HA's D&A in 2013 was calculated as 10% of total ESS' D&A and the value of D&A for 2018 was assumed to be that of 2013 plus 3% * 2018 HA revenue ($2018\ HA\ D\&A = €2.8m + €2.2m = €5.0m$). Thus, HA's NOPLAT for 2013 was computed to be €5.0m ($NOPLAT = EBIT * (1 - \text{effective tax rate}) \Leftrightarrow €5.0m = €7.1m * (1 - 29.7\%)$). The maintenance capex in 2013 was assumed as 10% of maintenance capex of ESS in 2013. In 2018 maintenance capex was computed via an increase of 3% relative to the previous year. The expansion capex is €20m spread from 2015 to 2017. NWC for HA was computed using the same reasoning as for HL's project. The probability undergoing this project was assumed to be 65% (TN Exhibit 2).

TN Exhibit 2 HA's project - Incremental data relative to 2013

EURm	2014	2015	2016	2017	2018	Terminal value
ΔOperating revenue	0.0	0.0	0.0	0.0	9.4	
ΔEBITDA	0.0	0.0	0.0	0.0	1.8	
ΔD&A	0.0	0.0	0.0	0.0	(2.2)	
ΔEBIT	0.0	0.0	0.0	0.0	(0.4)	
ΔTaxes	0.0	0.0	0.0	0.0	0.1	
ΔNOPLAT	0.0	0.0	0.0	0.0	(0.3)	
ΔCAPEX	0.0	(6.7)	(6.7)	(6.7)	(0.0)	
ΔChanges NWC	0.0	0.0	0.0	0.0	0.0	
ΔD&A	0.0	0.0	0.0	0.0	2.2	
ΔFree Cash Flow	0.0	(6.7)	(6.7)	(6.7)	1.9	29.7
Discounted FCF	0.0	(6.2)	(5.7)	(5.2)	1.4	19.9
Sum PV future FCF	4.2					
Probability	2.7					

Once HBA is a PPP agreement and can only belong to ESS until 2039, it needs to be valued separately from ESS. Additionally, it is difficult to predict whether or not the terms will be extended, which means probabilities will need to be attributed. The first term is from 2012 to 2021, the second is from 2022 to 2031 and the last one is until 2039. HBA was assumed to remain under the PPP agreement until 2021 with 90% probability, and due to the uncertainty regarding the extension of second and third terms, a 50% probability of extension was assumed from then on. Furthermore, in 2014, a probability of 75% was assumed regarding the possibility of receiving additional revenue of €2.2m due to HIV payments from the State, as well as an increase of 7% in 2014 revenues. From then onwards, revenues will grow by the same percentage as costs (1%, which is the expected long term inflation). Capex was assumed as 3.1% of operating revenue from 2014 to 2039 and changes in NWC were assumed to be very close to 0 (TN Exhibit 3).

TN Exhibit 3 Historical data and estimates for HBA

EURm	2011	2012	2013	2014	2015	...	2022	...	2031	...	2039
Operating revenue	0.0	52.2	82.1	89.5	90.4	...	96.9	...	106.0	...	114.8
Operating costs	(3.5)	(63.9)	(81.0)	(83.4)	(84.3)	...	(90.3)	...	(98.8)	...	(107.0)
EBITDA	(3.5)	(11.7)	1.1	6.1	6.1	...	6.6	...	7.2	...	7.8
D&A	0.0	(3.9)	(5.3)	(5.3)	(5.3)	...	(5.3)	...	(5.3)	...	(5.3)
EBIT	(3.5)	(15.6)	(4.2)	0.8	0.8	...	1.3	...	1.9	...	2.5
Taxes	0.0	0.0	0.0	(0.2)	(0.2)	...	(0.4)	...	(0.6)	...	(0.7)
NOPLAT	(3.5)	(15.6)	(4.2)	0.5	0.6	...	0.9	...	1.3	...	1.8
Changes NWC	0.0	0.0	0.0	0.1	(0.1)	...	(0.1)	...	0.0	...	(0.1)
CAPEX	0.0	(25.4)	(2.5)	(2.8)	(2.8)	...	(3.0)	...	(3.3)	...	(3.6)
D&A	0.0	3.9	5.3	5.3	5.3	...	5.3	...	5.3	...	5.3
FCF	(3.5)	(37.1)	(1.4)	3.0	3.2	...	3.3	...	3.3	...	3.6
Discounted FCF				3.0	2.9	...	1.7	...	0.9	...	0.5
Sum of FCF	25.7										

No other PPP agreements were expected to happen. Finally, it is critical to value ESS's private healthcare, other businesses and the corporate centre segments. From 2014 to 2018, both costs and revenue will grow at 3.0%. In 2014, D&A will be 7.0% of operating revenue and from 2014 until 2018 it will decrease annually 0.25%. Maintenance and expansion capex will be 2.50% and 3.75% of revenues, respectively. NWC will increase from 2013 to 2014, once in the first half on 2014 NWC was already €10.8m, and from then it will have small changes. (TN Exhibit 4).

TN Exhibit 4 ESS historical data and estimates *sans* its public healthcare business

EURm	2010	2011	2012	2013	2014	2015	2016	2017	2018	Terminal value
Operating revenue	250.2	273.6	289.2	291.5	300.2	309.3	318.5	328.1	337.9	
Operating costs	(212.7)	(223.7)	(238.7)	(233.6)	(240.6)	(247.8)	(255.3)	(262.9)	(270.8)	
EBITDA	37.5	49.9	50.5	57.9	59.6	61.4	63.3	65.2	67.1	
D&A	(26.5)	(26.4)	(24.6)	(22.8)	(21.0)	(20.9)	(20.7)	(20.5)	(20.3)	
EBIT	11.0	23.5	25.9	35.1	38.6	40.6	42.6	44.7	46.8	
Taxes	(3.3)	(7.0)	(7.7)	(10.4)	(11.5)	(12.0)	(12.6)	(13.3)	(13.9)	
NOPLAT	7.7	16.5	18.2	24.7	27.1	28.5	29.9	31.4	32.9	
NWC	32.0	67.6	11.4	0.8	12.8	7.8	6.5	8.2	4.5	
Changes NWC	n.a	35.6	(56.2)	(10.6)	12.0	(5.0)	(1.3)	1.7	(3.7)	
CAPEX	(23.6)	(7.5)	(32.5)	(12.5)	(18.8)	(19.3)	(19.9)	(20.5)	(21.1)	
D&A	26.5	26.4	28.5	28.1	21.0	20.9	20.7	20.5	20.3	
FCF	n.a	(0.2)	70.4	50.9	17.4	35.0	32.0	29.7	35.8	575.3
Discounted FCF					17.4	32.3	27.3	23.3	26.0	385.4
Sum of FCF	511.7									

The next step is to discount the computed FCFs of each of the projects described above. In order to do that, the WACC was computed. The market value of ESS as of the end of June was €353.5m ($€3.7 * 95.542m$) and the book value of debt³⁶ in the first half of 2014 was €206.3m, which implies a debt to equity ratio of 58.36%. The unlevered beta is 0.85, and using the debt to equity ratio, together with the corporate tax rate of 29%, the levered beta is calculated to be 1.20 ($Levered\ beta = Unlevered\ beta * (1 + D/E * (1 - corporate\ tax\ rate)) \Leftrightarrow 0.85 * (1 + 58.36% * (1 - 29.00\%)) = 1.20$). Moreover, in order to compute the cost of equity, both the risk free rate and the market risk premium were required inputs. As the transaction involves the acquisition of a Portuguese company, one should take into account the country risk premium. Thus, the risk free will be the average of 10-year Portuguese Government bond yield from May to July (3.62%), which already account for this risk. The market risk premium is assumed to be the historic one equal to 6%. All-in-all, the cost of equity equal to 10.83% ($Re = Rf + Beta\ levered * Market\ risk\ premium \Leftrightarrow 3.62\% + 1.20 * 6.00\% = 10.86\%$).

In 2013, ESS paid interest of €10.4m and had a total debt of €244.4m. The cost of debt in this year was estimated to be 4.26% ($€10.4m/€244.4m$). Since ESS is no longer

³⁶ Note that the book value was used due to a lack of market information pertaining to the company's debt, which implies an assumption that the beta of debt of ESS was assumed to be zero.

linked to BES, the cost of debt is expected to increase. Thus, the cost of debt in this valuation was computed at 5.75%. With these information the WACC was equal to 8.34% ($WACC = Re * E/(E+D) + Rd * (1 - corporate\ tax\ rate) * D/(E+D) \Leftrightarrow 10.83\% * 63.15\% + 5.75\% * (1 - 29.00\%) * 36.85\% = 8.34\%$). Since all the projects inherently have the same risk, the same WACC was used across the board. The perpetuity growth rate used was 2%, except of the case of HBA where no perpetuity was computed.

Following this, the sum-of-the-parts valuation technique was employed, in order to gauge value of each project and subsequently the entire company (through summing the discounted FCFs of each project). Thus, adding up the discounted FCFs from HBA (€25.7m), from the HA project (€2.7m), from the HL project (€20.2m) and from ESS without HBA (€511.7m), the enterprise value of ESS was computed to be €560.3m, which implies a price per share of €3.94 ($Equity\ value/\#\ shares \Leftrightarrow Enterprise\ value - 2014\ H1\ net\ debt/\# \ shares \Leftrightarrow (\€560.3m - \€184.1m)/95.542m$). However, one should note this is the standalone valuation of ESS, which means the premium and the potential share of synergies was not included. Additionally, ESS will have a decrease in its revenues due to the fact that it is no longer linked to Tranquilidade. Note, however, that the increase in revenues Fosun could bring would be higher than this decrease. All in all, one should conclude the price paid by Fosun was fair. The price Fosun paid represents a premium of 27.24% ($(\€5.01/\€3.94) - 1$), which is deemed fair due to the current situation of GES. Regarding the February IPO price (€3.2), the premium is 56.56%.

What happened?

On the 15th of October the takeover process came to an end and Fosun became the main shareholder of ESS. In an attempt to change the previous image of the group and the link to its previous owner, Espírito Santo family, ES Saúde changed its name to Luz Saúde, underlying the importance of Hospital da Luz in its new brand. In addition, the new icon of the group designed to be very similar to that of Fidelidade, which shows the ambition Fosun has to have both companies linked. In the beginning of December, ESS bought a plot of land adjacent to the one containing the already existing Hospital da Luz, which was seen as a clear sign that it is planning to expand HL. In the first nine months of 2014, the net income witnessed a fantastic growth of 57%, comparing with the same period in 2013, due to an enhancement in operational results, as well as in financial results, driven by a deleveraging process and cost of debt improvements.

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