



One of the guiding principles of the 12th Five-Year Plan (5YP) is “inclusive growth”: helping ensure that the benefits of the country’s economic growth are spread to a wider proportion of the population. Accordingly, the healthcare sector is expected to receive a major boost in the 5YP.

Healthcare sector: Overview

- China’s National People’s Congress approved a new national development strategy for the next five years (2011 to 2015) in March 2011.
- A key theme of the plan is the emphasis on quality over quantity in terms of economic growth and investments.
- The plan includes provision of improved social safety nets for China’s rural population with basic healthcare coverage for all.
- Healthcare related aspects of the new plan are in line with the blueprint for healthcare reforms announced in 2009.
- Biotechnology has been selected as a strategic emerging industry with government funding of more than RMB 12 billion for R&D of new drugs between 2011 to 2015.
- Special policy backing and funding is expected from the government. This could include a combination of government investment, preferential tax and fiscal policies, and preferential procurement policies.
- The government has emphasised foreign investment in the development of the healthcare sector.
- We are likely to see heightened interest in investment into healthcare sectors coming from strategic corporate investors as well as Private Equity funds.

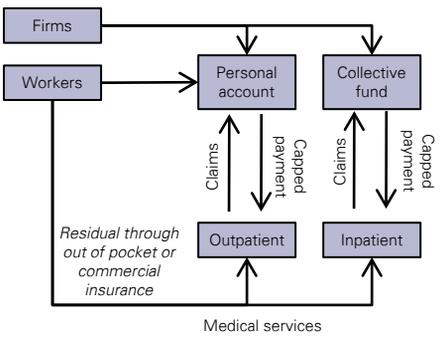
Top 10 Ministry of Health Priorities for 2011

1. Establish preliminary essential drugs list (EDL) system
2. Accelerate public hospital reform
3. Improve New Rural Cooperative Medical System and strengthen grass roots healthcare institutions' construction
4. Improve fairness of public health service
5. Strengthen food safety management and enhance supervision
6. Improve quality and management of healthcare service
7. Enhance drug quality supervision
8. Improve traditional Chinese medicines service
9. Strengthen healthcare professionals' education, improve technological advance and development
10. Encourage healthcare reform overall

China Healthcare Model

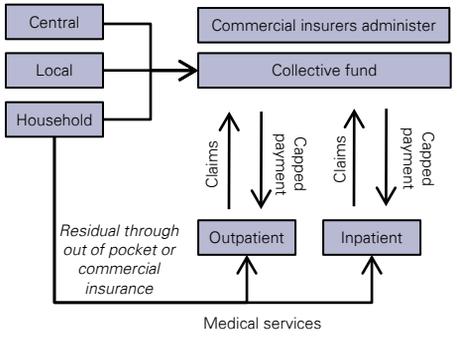
Urban Employee Basic Medical Insurance Scheme

Upper limit increased from previous 4x to 6x and likely to rise further during the 12th 5YP



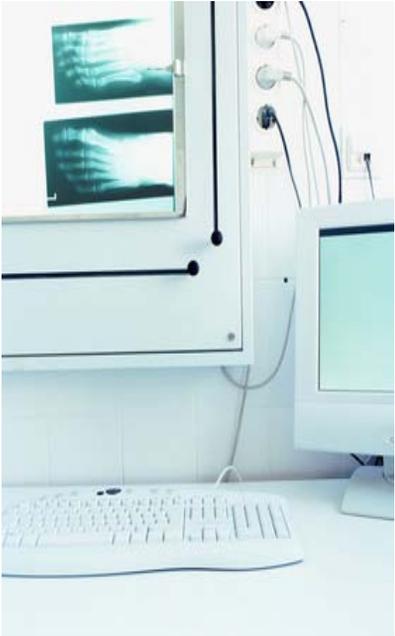
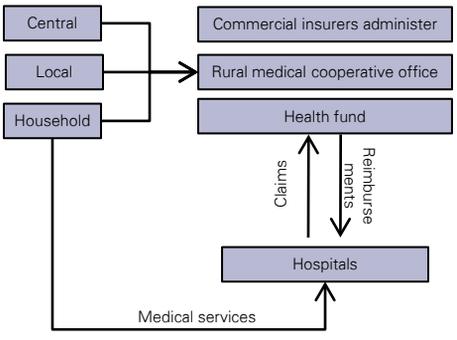
Urban Resident Basic Medical Insurance Scheme

Voluntary scheme, focussing on providing a medical safety net and coverage for non-employable urban residents



New Rural Cooperative Scheme

Social safety net for the rural population, subsidy to increase to no less than RMB 300 during the 5YP period



Upgrading China's healthcare system

- RMB 850 billion was earmarked in 2009 for the first phase of a three-year health service upgrade.
- The government's long-term policy target continues to be the development of an affordable and accessible healthcare system, with a medical insurance system covering the whole population.
- Government participation is likely to deepen with an increase in subsidies for the New Rural Cooperative programme (covering rural population) as well as increase in upper limit for the Urban Employee and Urban Resident Basic Medical Insurance Programme; reforms include
 - Poorer patients with severe medical conditions to be reimbursed at least 90 percent of their medical costs
 - Each new participant of the rural cooperative medical insurance programme to receive premium no less than RMB 300 – a 93 percent increase
 - Out-of-pocket payments to be limited to 30 percent by end of the 12th 5YP.
- Despite government steps to improve the healthcare coverage, healthcare spending in terms of share of GDP is unlikely to increase in the short term, given the small base of healthcare spending and barriers / fiscal constraints at the local level.



Healthcare industry 5Yp

The 12th 5Yp for the healthcare sector will extend the major policy blueprint as reflected from the healthcare system reform that began in April 2009. The directives for the 12th 5Yp focus on reinforcing the objective of developing an affordable and accessible healthcare system and infrastructure for the entire population. This objective is consistent with the country's emphasis on higher-quality growth over the next five years.

The plan's outline covers six main goals for the healthcare sector:

Strengthen public healthcare infrastructure

- Complete specialist healthcare services network and expand basic healthcare service offerings
- Continue to develop rural emergency healthcare network
- Implement healthcare education for the population
- Push for a ban on smoking in public places
- Create an E-healthcare database with coverage for 70 percent of urban residents
- Reduce maternal death to 0.022 percent and new birth death to 12 percent.

Strengthen healthcare service network

- Strengthen grassroots hospital and clinic infrastructure and network
- Encourage long term general practising in grassroot services
- Improve compensation system for grassroots healthcare institutions
- Encourage and introduce private capital into medical institutions.

Develop a comprehensive medical insurance system

- Establish medical insurance coverage for the entire population
- Increase insured amount and medical expenses payment ratio
- Improve payment and reimbursement system.

Improve drug supply system

- Establish and develop the procurement of essential drugs at grassroots hospitals
- Establish the essential drugs list, including pricing and reimbursements
- Strengthen the manufacturing of drugs and regulate drug procurement by healthcare institutions.

Reform the public hospital system

- Strengthen the social welfare function of public hospitals
- Encourage modernisation of hospital standards and practices
- Improve hospital process, with a focus on serving patients.

Support the development of Chinese medicine

- Continue to promote the development of Chinese medicine including the training of practitioners
- Strengthen the protection of Chinese medicine resources and research, establishing appropriate standards and practices
- Encourage the use of Chinese medicine essential drugs policies.

Healthcare focus activities – 12th 5Yp

1. Basic medical insurance system: increase basic medical insurance participation to ensure the entire population has basic medical coverage
2. Public healthcare service system: improve healthcare monitoring and specialist healthcare service infrastructure such as rural emergency and mental healthcare
3. Medical service system: improve capabilities of county level hospitals and strengthen the development of provincial maternal hospitals, local general hospitals in outer regions and county level Chinese medicine hospitals
4. Training of general practitioners: develop standardised training of general practitioners, with an aim to develop 150,000 general practitioners
5. Drug and healthcare information database: develop a healthcare information database for grassroots institutions, including development of Class III and county level long distance medical information system and public hospital medical information system



Implications of the plan

The successful execution of the programmes in the 12th 5YP will be critical to the upgrading of domestic healthcare. Government resources are likely to be channeled towards the expansion of medical insurance coverage, provision of preventive medical treatment and building of healthcare infrastructure, especially in rural areas.

- Expansion of medical cost reimbursements is expected to be a key driver for growth as the government aims to increase subsidy coverage as well as limit out-of-pocket payments during the 12th 5YP period.
- Local government fiscal constraints could provide short term challenges to 5YP implementation. The essential drugs list is likely to be an exception.
- Given the policy targets in the healthcare reform and 12th 5YP, the sector is likely to move in the direction of more innovation, product upgrades, cost control and more sustainable and environmentally friendly developments. For example, the government has brought biological medicine development to a strategic level and the plan is pushing for not just quantity but also “strong” development of the industries.
- The plan may accelerate consolidation across the healthcare sector as the government implements directives and further strengthens regulations and standards in the industry.

Sector impacts: Pharmaceutical

- Pharmaceutical distribution is expected to undergo significant restructuring and reorganisation.
- The government is seeking to consolidate the fragmented market to create a few mega-pharmaceutical groups with more than RMB 100 billion annual sales and 20 regional pharmaceutical distribution companies with more than RMB 10 billion annual sales.
- One objective is to increase the proportion of chain retail pharmacies from current one-third to two-thirds to enhance the connection between national and regional services.
- Building and consolidation of pharmaceutical distribution channels may bring about higher efficiency as well as improve the quality and level of service based on new distribution system and marketing approach.
- There has already been significant M&A competition among pharmaceutical distributors as they jockey to be the market leaders.
- Restructuring plans will likely trigger further acquisitions, especially from large state-owned distributors.
- Medicine manufacturing (mainly biological) will receive a boost from the government in terms of funding support (around RMB 40 billion over the 5YP period) as well as in terms of policies, tax and R&D incentives.
- There will be emphasis on building China into a strong drug manufacturing country which is capable of independent innovation, increased exports and global pricing power.

Sinopharm: potential opportunities from healthcare restructuring

- Biggest pharmaceutical group in China and undergoing a series of M&A activities to consolidate its position as a dominant player
- Between 2004 and 2008, investment has been focused on building its national distribution and retail network, with targets focused on the following
 - Regional distribution leaders
 - 2nd and 3rd tier cities expansion
 - Traditional retail channels as well as emerging channels such as e-commerce
- In the last 2 years, apart from further strengthening its distribution network through acquisitions, there has been an emphasis on product research and development
- The company has announced it will further invest USD 759 million for M&A activities in the next two years after making around 60 acquisitions since September 2009.

Chindex International Inc: broad benefits from the reforms

Healthcare services

- Owners of United Family Healthcare, one of the market leading providers of premium healthcare services in China
- Clinics in Beijing, Shanghai and Guangzhou, mainly focused on top income earners
- Expansion plan to triple the size of the network by 2013, as well as expand geographically
 - > Organic growth from new sites for hospitals and clinics
 - > Expansion of management into other existing hospitals (e.g. Huashan Pudong Hospitals)
 - > Funding of more than USD100 million for expansion plans
- Plan aligns with healthcare reform, economic stimulus program and clear benefits for private capital liberalization of foreign investment in healthcare services to increase depth of penetration in the Chinese market

Medical equipment

- Leading American supplier of capital medical equipment in China
- Formed strategic JV with FosunPharma, the largest private medical and pharmaceutical enterprise in China
- Expect healthcare reform will help to double customer base and new product introductions
- Aim to further grow R&D and manufacturing through M&A strategies targeting both Chinese domestic as well as Western medical technologies

Sector impacts: Healthcare services

- The 12th 5YP aims to encourage private capital investment into healthcare services, a reiteration and continuation of existing healthcare reforms.
- We are seeing the reduction of barriers to private investment, including medical institutions reclassified as a “permitted” investment category in the revised Foreign Investment Catalogue (originally “restricted”).⁽¹⁾
- Recent policies on improving tax benefits have levelled the playing field between for-profit and non-profit institutions.
- There are potential benefits for foreign hospital operators who are looking to enter the China market and for certain domestic players to expand their coverage and operations.
- Small domestic operators may also benefit from collaboration with more experienced foreign operators; future M&A may be a potential route of entry.

Sector impacts: Medical equipment

- A key theme in the 12th 5YP is the strengthening of the hospital service network including the development of healthcare infrastructure (hospitals and clinics, etc).
- Guidelines for healthcare reforms in 2011 continue to emphasise support for the development of county level hospitals and clinics in rural areas.
- Medical device manufacturers are likely to benefit from the development of healthcare infrastructure, especially manufacturers of basic equipment and suppliers for hospitals and clinics.
- The government is likely to further support private hospitals in purchasing medical equipment, in line with its efforts to support private capital into the hospital services sector.
- The government will likely continue to support the development of medical devices given its aim to develop further independent intellectual property as well as to increase exports of medical devices.
- Industry standards for medical devices were released at the end of 2010 which will help to develop the industry in a more regulated way and improve the overall product quality.
- Manufacturers with larger market shares may benefit as small players are likely to be acquisition targets or may struggle to compete if they do not have the funding for R&D or cannot upgrade to meet new standards.



China Head of Healthcare

Andrew Weir

Partner in Charge, Healthcare
andrew.weir@kpmg.com



China and Asia Head of Pharmaceutical

Norbert Meyring

Partner in Charge, Pharmaceutical
norbert.meyring@kpmg.com



Hong Kong Head of Healthcare

Peter Wong

Partner, Healthcare
peter.wong@kpmg.com



Healthcare

Mei Dong

Director, Healthcare
mei.dong@kpmg.com



Business opportunities

- We are likely to see an increase in M&A activities across healthcare broadly and especially in pharmaceutical distribution, an area where companies are looking to further strengthen their distribution channels as well as R&D capabilities.
- Private capital investment is going to be a key driver in the healthcare service sector as the government aims to boost penetration and coverage; the opening up of the sector could provide opportunities ranging from the low-end to the high-end, from specialty to general hospitals.
- Consolidation is likely to bring opportunities for the larger healthcare services and product providers, as small companies are merged or eliminated.
- There may be further opportunities for foreign investment into the healthcare sector as the government continues to open up the industry and permit new operators to enter.

Challenges and risks

- Despite central government efforts to push for broader, more affordable and accessible healthcare services to the entire population, bottlenecks from the provincial governments may cause potential delays in the roll-out of the plans.
- The potential implementation of the essential drugs list model is likely to place further pricing pressure and have negative implications for most manufacturers apart from the few designated suppliers for drugs on the list.
- New regulations are likely to raise compliance costs for companies, and at the same time, may impact small manufacturers which may not have adequate resources to meet compliance requirements.

CEO checklist

- Would your company stand to benefit from increased R&D investment and IP protection within China? How can you capitalise on this trend?
- What are the staffing implications for your business arising from increased healthcare insurance provisions?
- How can you support or respond to greater informatisation across healthcare providers in China?
- If you are a foreign entity, do you have the right partners to succeed in a large market where regulation will also continue to drive market developments?

Source: (1) National Development and Reform Commission and Ministry of Commerce, Consultation Draft of Revised "Foreign Investment Guidance Catalogue", April 2011

DISCLAIMER: The information herein has been obtained from public sources believed to be reliable. The views and opinions in this memo are those of the authors. KPMG makes no representation as to the accuracy or completeness of such information.

