Summary of the rating report

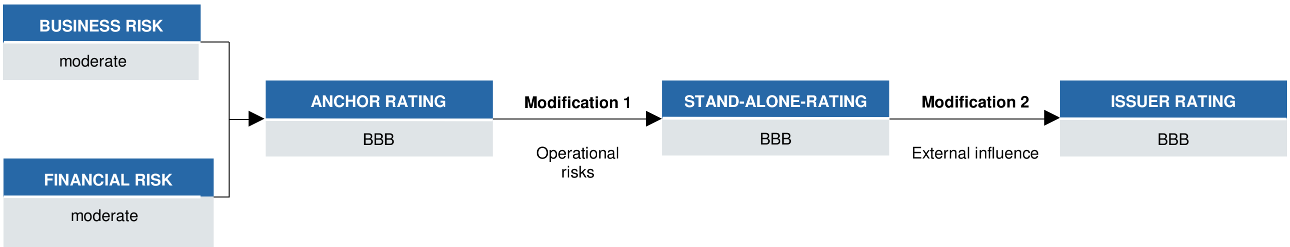
Schön Klinik SE

30 May 2017

EULER HERMES Rating

Issuer rating

Schön Klinik SE		30 May 2017	BBB
		Issuer rating	
		Outlook	stable
Industry	Holding of shares in companies that specialise in the construction, acquisition and operation of hospitals	2016 revenue	€ 797 million
		2016 employees	6,856



BUSINESS RISK	moderate

- Good market position due to specialisation
- High stability due to low sensitivity to cyclical trends
- High growth potential due to demographic trends and to acquisitions and internationalisation
- Dependence on regulatory framework

OPERATIONAL RISKS	- 0

- Innovative, effective management
- Implementation of succession plan still ongoing
- Appropriate handling of operational risks overall

FINANCIAL RISK	moderate

- Good operating earnings
- Sustained positive internal financing potential
- Good capital structure
- Slight increase in financial risk from regulation, international expansion and digitisation costs

EXTERNAL FACTORS	± 0

- No external factors of relevance for the rating

Financial ratios *	2014 actual	2015 actual	2016 actual
EBITDA margin (%)	18.9	18.1	17.1
ROCE (%)	3.9	4.5	4.2
Equity-to-total asset ratio (%)	46.4	47.5	41.7
Leverage (%)	42.6	41.7	44.5
Total liabilities / EBITDA	6.0	5.5	6.4
Net debt / EBITDA	3.9	3.6	3.7
EBIT interest coverage (net)	1.5	1.7	1.6
EBITDA interest coverage (net)	4.1	4.4	4.8

* Adjusted based on EHRG's analytical policies

EULER HERMES Rating

Rating rationale

Euler Hermes Rating reaffirms its BBB rating for Schön Klinik SE. We expect the rating to remain stable over the next twelve months.

Moderate business risk from stable business model and increasingly challenging regulatory environment

In our view, the Schön Klinik Group has a **moderate business risk**. Rating strengths include a good market position from the Group's specialisation in attractive medical growth disciplines, a large share of privately insured patients and the overall stability of its business model. The Group enjoys sustainable growth potential in Germany due to demographics, domestic acquisitions and systematic expansion in its core disciplines of psychosomatics, orthopaedics and neurology. Changes in the regulatory environment have increased profitability risks. The negative impact has been particularly pronounced for growing and specialised hospitals. At the same time, we expect required investments in digitisation and the execution of Hospital 4.0 programmes to pick up over the medium to long term. Schön Klinik has addressed these changes vigorously, in our view, by constantly improving its service portfolio, increasing its attractiveness to privately insured patients and self-payers, and executing its internationalisation strategy with specialised hospitals. With its effective management and flexible organisational structures, we believe that the Schön Klinik Group can readily adapt to constantly changing general conditions and so assume that its adaptability and high process efficiency will enable it to continue growing profitably. Risks include changes in the regulatory regime, rising cost pressures, the digitisation and technologisation of medicine and the growing scarcity of skilled workers.

Moderate financial risk; good operating earnings power and internal financing potential are accompanied by slightly increased financial risks from regulation, international expansion and digitisation

We consider the Schön Klinik Group's **financial risk** to be **moderate**. Its operating earnings power is above-average compared to its peer group. This is driven by its highly focused medical specialisation and its income structure, which, unlike its peer group, is characterised by a large share of privately insured patients. The Group's internal financing potential is positive for the long term. It has a highly stable operational cash flow due to the large number of episodes of care and the mandate held by its acute care hospitals to provide medical care. We rate the Group's capital structure as good. We expect its deleveraging potential to remain satisfactory over the medium term. Interest coverage ratios should improve to a highly satisfactory level over the medium term as mezzanine capital is refinanced at lower interest rates and its financial indebtedness declines overall. In Germany, regulatory changes are already having an adverse impact that will only worsen in the future (structural cost problem). To compensate, the Schön Klinik Group plans to diversify more outside Germany over the long term. The resulting up-front costs and start-up losses will lower operating earnings over the short to medium term. Over the medium to long term, we expect domestic profitability to decline slightly due to the ongoing structural cost problem. When combined with the risks of international expansion and the possibility of higher investment budgets for digitisation, we expect financial risks to increase slightly overall.

No modifications to the anchor rating

In our view, the Group has adequate structures, processes and systems in place in order to achieve its strategic goals. We believe the operational risks are consistent with the anchor rating. There are no external factors of relevance to the rating. Therefore, no modifications were made to the anchor rating.

Rating history

	24 April 2014	30 April 2015	29 April 2016	30 May 2017
Rating	BBB	BBB	BBB	BBB
Outlook	stable	stable	stable	stable

Company

Rating subject SKS: extensive corporate reorganisation in connection with succession plan

Schön Klinik SE (“SKS”), headquartered in Prien am Chiemsee, is the parent and financial holding company of the Schön Klinik Group. The Group has been reorganising its corporate structure since 2013. The main motivation for the reorganisation was to lay the structural groundwork for the gradual, long-term hand-off of the company to the next generation. It also aims to improve the available options for funding growth and operations. The Group’s fixed assets were remeasured as part of the corporate reorganisation.

SKS shareholders, management and board of directors

75% of Schön Klinik SE is owned by the Schön family holding company and, as of 2016, 25% by the Carlyle Group, an investment firm. The managing directors of Schön Klinik SE are Dieter Schön, Dr Markus Hamm and, as of summer 2016, Christopher Schön. The eight-member board of directors consists of Mr and Mrs Schön, Christopher Schön, Dr Markus Hamm, Dr Astrid Wimmer, Hubert Seitz and two Carlyle representatives.

SHD: Holding and management company

Schön Holding SE & Co. KG (SHD) holds the equity in the individual hospitals and also serves as a management holding company. Its managing directors are Carla Naumann, Dr Michael Knapp, Andreas Ludowig and Patrick Mickler.

Schön Group: one of Germany’s largest hospital operators

The Schön Klinik Group is one of the largest for-profit hospital operators in Germany. The Group and its hospitals generated approx. € 797 million in gross revenue in 2016. Around 104,000 episodes of in-patient care were provided in 2016. The hospitals had over 4,803 beds as of 31 December 2016. The Schön Klinik Group employed 6,856 people (full-time) as of 31 December 2016. Its main competitors are Rhön Klinikum AG, Helios Kliniken GmbH, the Asklepios Group and Sana Kliniken AG. The Schön Klinik Group has positioned itself in the market as a high-end provider. Around 27% of its patients are privately insured, are self-payers or have supplemental medical plans.

Medical specialties: orthopaedics, psychosomatics and neurology

All of the Schön Klinik Group’s hospitals have traditionally been located in Germany (Bavaria, Hamburg, Hesse, Schleswig-Holstein and North Rhine-Westphalia). It generates around 88% of its revenue with acute care and around 12% with rehabilitative care. Its medical specialties are orthopaedics, psychosomatic medicine, neurology, surgery and internal medicine. It is currently building its first international hospital (London), which is scheduled to open in early 2018.

Disclaimer

This report represents a highly abridged summary of the complete rating report issued on 30 May 2017. The full rationale for the rating notation is given in the complete rating report that was presented to the company and has not been published by Euler Hermes Rating GmbH.

Schön Klinik SE (client and rated entity) engaged Euler Hermes Rating GmbH to conduct a rating on 9 February 2015 (amended on 31 March 2017). The company was visited on 31 March 2017.

The Rating Committee of Euler Hermes Rating GmbH reviewed the rating process, issued the rating notation and approved the rating report in its current form on 30 May 2017. This rating report was given to the client on 14 June 2017, thereby concluding the rating process.

The rating is Euler Hermes Rating GmbH's opinion of the creditworthiness of a rating subject. It is not a statement of fact. Euler Hermes Rating GmbH is not engaged in buying or selling securities. Its rating report is neither a prospectus nor a substitute for information assembled and presented by companies or issuers for investors regarding the purchase of a security or for assessing the creditworthiness of a rated entity. The rating is not a recommendation to participate in certain facilities. All recipients of the information must conduct their own independent analyses, credit assessments and other verifications and evaluations that are customary and necessary in order to reach a final decision about participating in certain facilities.

The rated entity is solely and exclusively liable for any errors and omissions in the documents and information openly and willingly provided to us in response to our requests for information. The rated entity has reviewed the rating report and certified that all the information considered in the rating report is accurate and complete in all significant respects, no significant aspects have been concealed and any forward-looking statements are based on plausible, verifiable and current data and were prepared by the rated entity exercising reasonable and commercial care. The rated entity's representatives have issued a written certification of completeness to Euler Hermes Rating GmbH. However, the rated entity cannot be held liable if actual results differ from the forward-looking statements presented in this document, particularly the projections. Forward-looking statements and projections may be adversely affected by unforeseeable events and changes in the economic environment. Euler Hermes Rating GmbH assumes no liability for the accuracy of the information it considers when issuing a rating and extends no guarantee whatsoever that the information is explicitly or implicitly correct, timely, complete, suitable for the market or fit for any particular purpose.

If the rating is published on Euler Hermes Rating GmbH's website (www.eulerhermes-rating.com) or published for subscribers (e.g. on a portal), it will be followed by a subsequent one-year monitoring process. During this period, the rated entity and the environment in which it operates will remain under observation. The representatives of the rated entity remain subject to a full disclosure obligation during this period. Any change in Euler Hermes Rating GmbH's rating assessment will result in a change in the published rating notation, meaning that the rating notation shown on the internet represents the current rating assessment at all times. The rating will only remain published after the end of the monitoring period if the rating process is repeated.

Please note that summaries of contracts, laws and other documents contained in the rating report cannot replace careful study of the complete texts. Euler Hermes Rating GmbH cannot guarantee that the information used to prepare this report has not changed since it was collected and is still accurate at the time of publication. Euler Hermes Rating GmbH is under no obligation to complete the information that it considered when issuing the rating.

The dissemination and use of this rating report may be prohibited by law in certain jurisdictions. Euler Hermes Rating GmbH therefore recommends that any persons who come into the possession of this information inquire about and comply with any prohibitions that may be in place. Euler Hermes Rating GmbH assumes no liability of any kind with respect to the dissemination and use of the rating in any jurisdiction whatsoever.

Euler Hermes Rating GmbH

Hamburg, 14 June 2017

Analysts

Gundel Bergknecht, Senior Analyst and Project Manager
Jörg Walbaum, Senior Analyst

Rating committee

Holger Ludewig, Director
Matthias Peetz, Senior Analyst

Principal sources of information

- Consolidated financial statements for 2014, 2015, 2016
- Reports from the internal reporting system
  (e.g. 2016 business performance, analysis of bank liabilities)
- Market analyses
- Strategy paper and corporate planning
- Documents on legal structure
- Talks with management

Rating methodology

Euler Hermes Rating GmbH Methodology: Issuer Rating of May 2016
(http://www.ehrg.de/seiten/Methodology2016.pdf)

Appendix 1: Rating Categories

Category	Definition
AAA	In the opinion of the rating agency, AAA rated entities demonstrate excellent credit quality and the lowest default risk.
AA	In the opinion of the rating agency, AA rated entities demonstrate very high credit quality with a very low default risk.
A	In the opinion of the rating agency, A rated entities demonstrate high credit quality with a low default risk.
BBB	In the opinion of the rating agency, BBB rated entities demonstrate highly satisfactory credit quality with a moderate default risk.
BB	In the opinion of the rating agency, BB rated entities demonstrate slightly satisfactory credit quality with a slightly increased default risk.
B	In the opinion of the rating agency, B rated entities demonstrate low credit quality with an increased default risk.
CCC	In the opinion of the rating agency, CCC rated entities demonstrate very low credit quality with a very high default risk.
CC	In the opinion of the rating agency, CC rated entities demonstrate very low credit quality, an event of default is very likely.
C	In the opinion of the rating agency, C rated entities demonstrate very low credit quality, an event of default is imminent.
D / SD	D rated entities have defaulted, as defined by the credit rating agency. The rated entity is assigned an SD rating (Selective Default) if it has only defaulted on certain debt obligations.
PLUS (+) **MINUS (-)**	Rating notations from AA to CCC are modified by a PLUS (+) or MINUS (-) where required in order to show their relative position within the rating category.

EULER HERMES Rating

Appendix 2: Definition of ratios

Earnings potential and profitability

EBITDA margin

EBITDA margin
Numerator
EBITDA
Denominator
Total revenues

Returns

ROCE
Numerator
Adjusted operating result (= EBIT)
Denominator
Net financial liabilities + economic equity (= capital employed)

Total return on capital
Numerator
Adjusted operating and financial result + interest expense
Denominator
Adjusted capital

Cash flow return on investment

Cash flow return on investment (cash flow ROI)
Numerator
EBITDA
Denominator
Adjusted total capital

Capital structure and debt to equity ratio

Debt

Equity ratio
Numerator
Adjusted equity (=economic capital)
Denominator
Adjusted total capital

Debt to equity ratio
Numerator
Net financial liabilities
Denominator
Net financial liabilities + economic equity (= capital employed)

Net financial liabilities

Net financial liabilities
Bonds
+ Liabilities to banks
+ Bill Liabilities
+ Other interest-bearing liabilities
+ Operating lease liabilities
+ Adjustments for ABS / factoring transactions
- Cash and cash equivalents

Degearing periods

Total liabilities / EBITDA
Numerator
Total capital - economic capital (=total liabilities)
Denominator
EBITDA

Net financial liabilities / EBITDA
Numerator
Net financial liabilities
Denominator
EBITDA

Interest coverage

EBIT interest coverage
Numerator
Adjusted operating result (= EBIT)
Denominator
Interest expense

EBITDA interest coverage
Numerator
EBITDA
Denominator
Interest expense