

NOVEMBER 2018 Industry snapshot

DENTAL DISTRIBUTION: THE PERFECT STORM

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HIGHLIGHTS



JACK HELM
SECTOR HEAD

We like dental ...

We at Clairfield enjoy working in the dynamic dental services, manufacturing, and distribution sector. Unfortunately, we also believe that “the perfect storm” is upon the sector, accelerated by Amazon (referred to as “the death star” by industry participants), which has announced a foray into dentistry. Dental manufacturing margins have been spared to date, but for how much longer? We look for M&A consolidation to accelerate sharply particularly for dental practice chains, and see continued margin pressure until distributors and producers rationalize excess capacity or elect to “go direct” – bypassing distributors and selling directly to their customers. We see 1-3 years of continued pain and are well-positioned to advise on how best to exploit a rapidly changing market.

What is driving consolidation?

To say that the dental sector is radically changing is putting it mildly. Every subsegment is being impacted by state budget pressures, internet price arbitrage, and the phenomenon of dental chains with salaried dentists no longer in a position to decide major practice investments. The dental manufacturing business for chairs, imaging, suction, denture milling, etc., used to be a comfortable 18-25+% EBITDA environment, but current profitability is under assault. Even large and sophisticated M&A-driven groups such as Danaher, Henry Schein, and Dentsply Sirona have few financial engineering tools left to defend their share prices.

The cautionary tale of Dentsply Sirona

Note the highly touted USD 13.3 billion mega-merger between giants Dentsply and Sirona announced in the fall of 2015. When in mid-2017 management failed to deliver on the promised synergies, the entire management team was replaced and the combined entity took a USD 1.5 billion goodwill impairment. The Dentsply Sirona share price fell some

40% and has yet to recover. Dentsply Sirona was a spectacular sector and M&A failure. Dentsply Sirona may be the exception, but it is no coincidence that it occurred in the dental sector as analyst pressure drove management to overpromise in M&A at a time when distribution margins indicated a sector downturn.

Extreme pressure in distribution, many spin-offs

Dental distribution has been hardest hit by lowest cost search engines that chip away at contribution margins from dental consumables. A negative equity research article published by Morgan Stanley in December 2017 was sufficient to send the whole sector down 6% (see charts in the following pages). Dental distribution giant Henry Schein continues to restructure and has since spun off and merged its animal health business with Vets First. Danaher will also spin off its dental business in the fall of 2019. European distributors, particularly in Germany, are suffering the most from low-cost internet platforms that erode consumable margins. And just when you thought it was tough enough, the growth of dental practice chains has added to margin pressure via bundled procurement.

So what does all this mean?

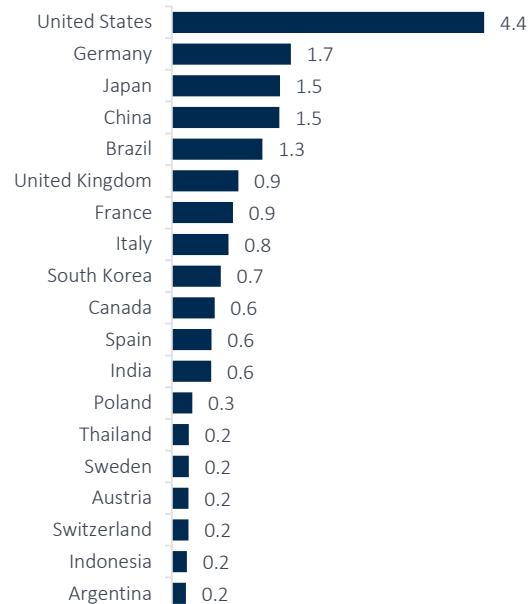
It means that the pain in dental is not yet at an end, valuations have likely peaked, and that services (individual practices or platforms) are commanding higher prices as PE groups bid up pricing in this historically lucrative segment. We at Clairfield are by nature optimistic when it comes to valuations; however, we believe dental players must rethink past strategies and focus on technical and internet-based service support, both to the patient as well as to the practice. Whether filling cavities or selling sophisticated CAD/CAM devices to labs, direct technical service and consulting support will be the hallmark of the brave new dental world. We would enjoy discussing or evaluating your strategic objectives in the fast-moving dental marketplace.

SECTOR TRENDS AND SELECTED CASE STUDIES

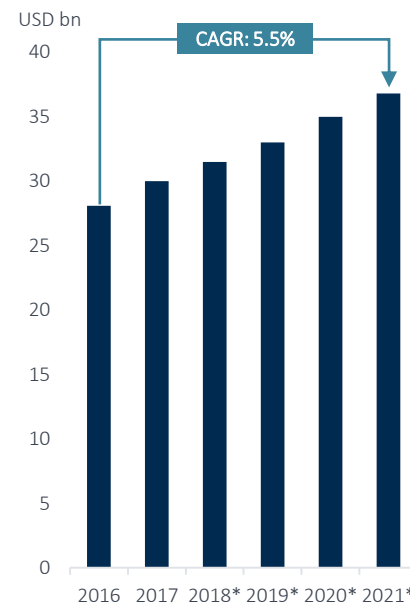
Dental sector trends

- To date, dental manufacturers have been able to defend margins whereas distributors have been facing internet price arbitrage wherever low-cost search portals are able to go directly to the source.
- Manufacturers will also eventually suffer as these same distributors will fight for higher discounts on products, forcing manufacturers to either accept a lower margin or to go directly to the client, a strategy which could be accompanied by higher marketing and logistics costs.
- Another source of margin pressure for both manufacturers and distributors is the phenomenon of dental chains, where a centralized procurement function has one purpose only: to reduce costs.
- Private equity investors are driving an explosion of dental chains through a “buy and build” consolidation approach, since they see any reimbursable healthcare segment as a multiple arbitrage situation funded by stable cash flows and cheap interest rates.
- Manufacturers and distributors are both increasingly forced to defend the “last mile to the client” via service and technical support.

Revenue of the oral care market in by country, 2017 (in USD billion)



Estimated global dental market, 2017 (in USD billion)



Selected dental sector M&A

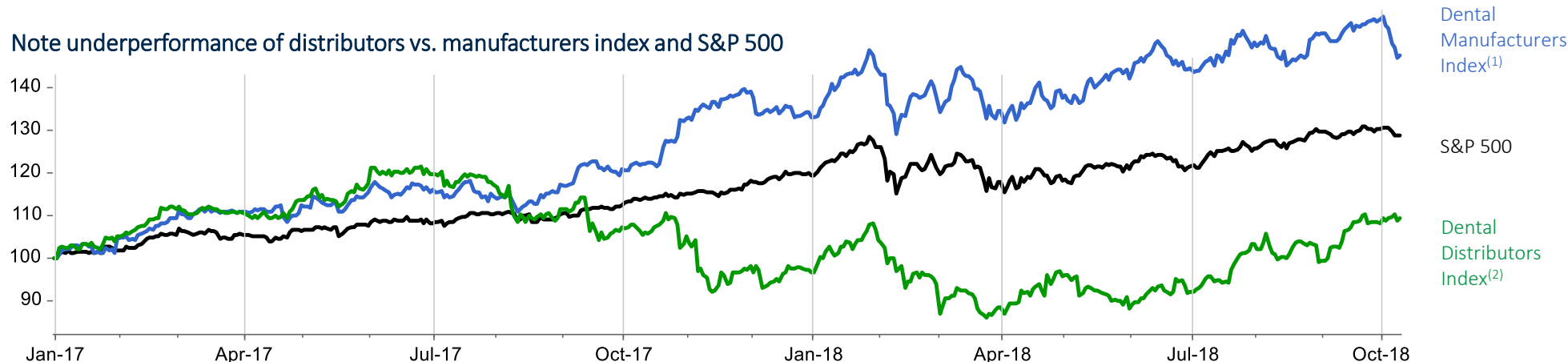
- Capvis Private Equity Partners acquired Amann Girschbach from TA Associates in April 2018 for an estimated EUR 325 million.
- Unconfirmed deal multiple was approximately 13.5x EBITDA.
- TA Associates ran a very aggressive dual track M&A process.

- In 2015 Dentsply paid USD 5.6 billion in shares for Sirona; the company had combined revenue of USD 3.5 billion.
- Merger synergies of USD 125 million per annum were expected between the two companies.
- In January 2018, management was forced to resign as these synergies were not achieved. Stock dropped from high of USD 67 to USD 38.

- Danaher acquired Nobel Biocare in 2014 for the comparatively high price of EUR 1.67 billion or 18.4x EBITDA and 3.0x revenues.
- Via M&A bolt-ons, Danaher has subsequently built up a healthy USD 3.5 billion market share in dental implants.
- Danaher plans tax-free spin-off of dental activities as new DentCo entity for fall 2019.

DENTAL SECTOR STOCK MARKET PERFORMANCE

Note underperformance of distributors vs. manufacturers index and S&P 500



⁽¹⁾Dental Manufacturers Index includes the 13 Dental Manufacturing Companies listed below.

⁽²⁾Dental Distributors Index includes the 3 Dental Distributors listed below.

Comparable company analysis

Dental Manufacturers	Share price 09.10.2018	% of 52 week high	Enterprise Value ⁽¹⁾ (EUR m)	Net Debt (EUR m)	Market Value (EUR m)	Sales (Latest) (EUR m)	EBITDA – Margin	EV / Sales			EV / EBITDA		
								2018E	2019E	2020E	2018E	2019E	2020E
Align Technology Inc.	€ 297.28	86.56%	22,293	(601)	23,878	1,306	26.56%	12.94x	10.29x	8.41x	48.61x	36.99x	29.21x
Aoxin Q&M Dental Group	€ 0.14	86.14%	44	(12)	54	13	19.94%	NA	NA	NA	NA	NA	NA
BIOLASE Inc.	€ 1.36	40.02%	25	(10)	28	42	(34.80%)	0.62x	0.57x	NA	NA	NA	NA
Coltene Holding AG	€ 91.24	84.22%	428	(12)	447	151	18.58%	2.52x	1.91x	1.81x	14.31x	11.32x	10.21x
Danaher Corporation	€ 93.06	97.49%	73,417	8,238	65,116	16,251	24.11%	4.24x	4.05x	3.89x	17.76x	16.57x	15.57x
DENTSPLY SIRONA	€ 31.17	53.15%	8,269	1,052	6,930	3,540	20.86%	2.38x	2.31x	2.24x	12.91x	12.04x	11.17x
Meta Biomed Co.	€ 2.97	48.92%	69	42	71	51	7.54%	NA	NA	NA	NA	NA	NA
Osstem Implant Co.	€ 37.49	65.69%	535	23	536	312	7.76%	1.52x	1.34x	1.20x	15.80x	11.97x	10.10x
SDI Limited	€ 0.36	86.61%	39	(4)	43	48	19.13%	NA	NA	NA	NA	NA	NA
Shinhung Co.	€ 7.81	75.64%	85	16	75	95	5.41%	NA	NA	NA	NA	NA	NA
Shofu Inc.	€ 10.32	89.97%	129	(32)	166	186	10.29%	NA	NA	NA	NA	NA	NA
Straumann Holding	€ 598.33	82.67%	9,072	(69)	9,501	1,002	28.79%	7.71x	6.74x	5.94x	25.99x	22.18x	19.11x
Value Added Technology Co.	€ 23.02	70.49%	345	18	342	172	20.67%	1.87x	1.68x	1.51x	8.61x	7.55x	6.74x
Mean								4.22x	3.61x	3.57x	20.57x	16.94x	14.59x
Median								2.45x	2.11x	2.24x	15.80x	12.04x	11.17x

Dental Distributors	Share price 09.10.2018	% of 52 week high	Enterprise Value ⁽¹⁾ (EUR m)	Net Debt (EUR m)	Market Value (EUR m)	Sales (Latest) (EUR m)	EBITDA – Margin	EV / Sales			EV / EBITDA		
								2018E	2019E	2020E	2018E	2019E	2020E
Henry Schein Inc.	€ 76.55	97.34%	13,641	1,242	11,721	11,048	8.45%	1.17x	1.11x	1.06x	14.08x	13.28x	12.55x
Lifco AB	€ 37.40	92.08%	3,632	356	3,170	1,041	18.70%	3.25x	3.08x	2.96x	17.76x	16.86x	16.31x
Patterson Companies	€ 20.63	59.82%	2,648	788	1,957	4,628	5.56%	0.54x	0.53x	0.51x	11.14x	10.38x	10.40x
Mean								1.65x	1.57x	1.51x	14.33x	13.51x	13.09x
Median								1.17x	1.11x	1.06x	14.08x	13.28x	12.55x

SEVERE MARGIN PRESSURE IN DENTAL DISTRIBUTION

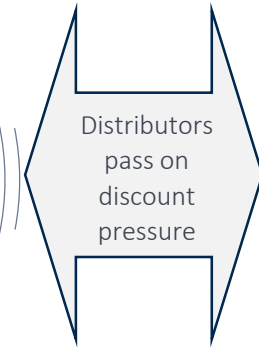
Governmental Cost Containment



Private Equity Investors/ Dental Chains



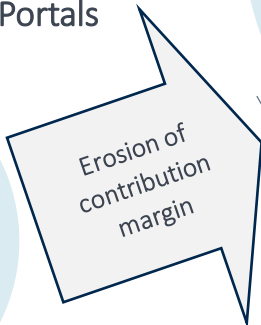
Distributors



Manufacturers



Online Sellers/ Price Comparison Portals

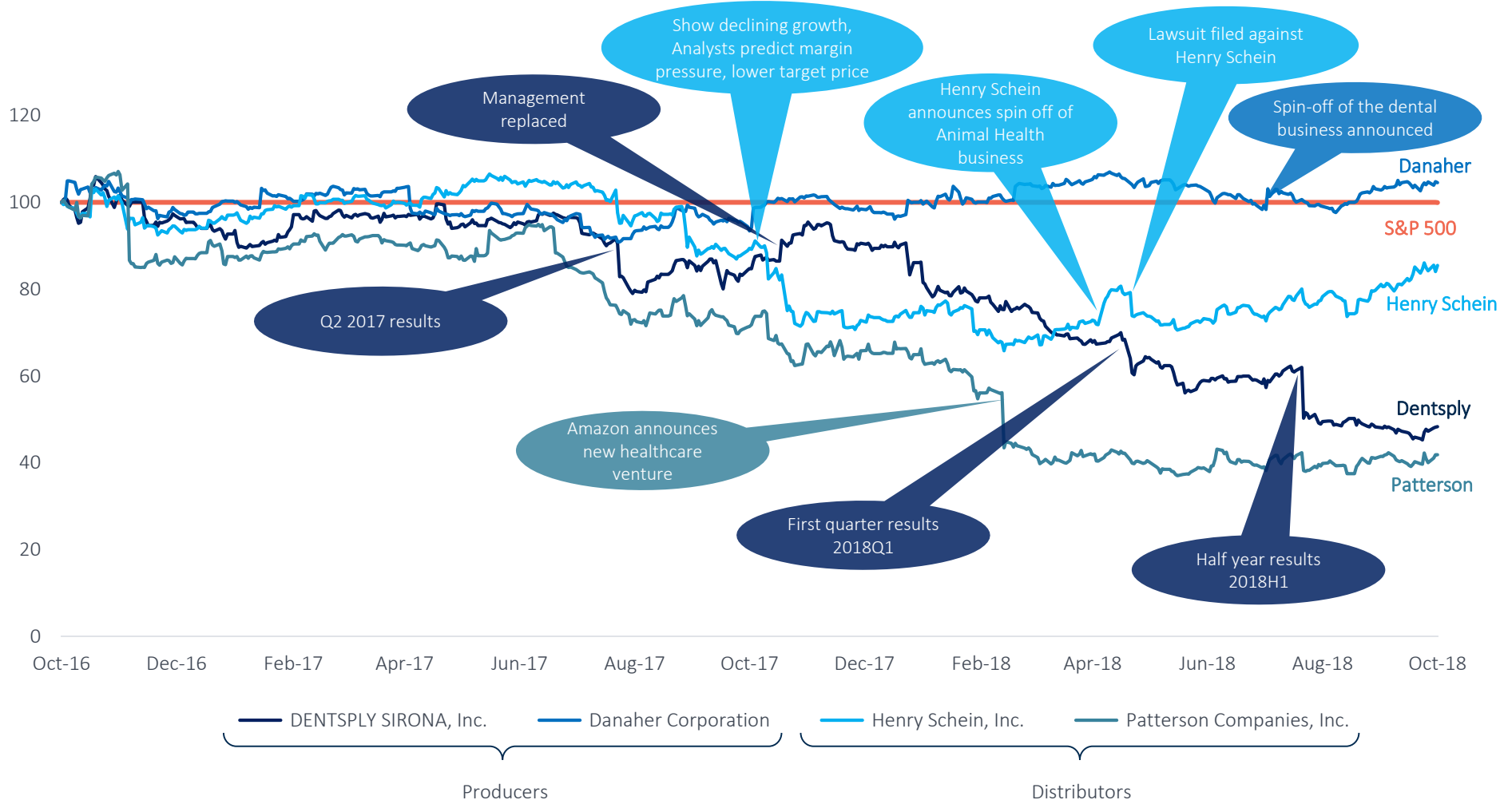


PRIMARY EFFECT

SECONDARY EFFECT

HOW LONG CAN THE MARGIN PAIN LAST?

Key players: share price performance relative to S&P 500 over the last 2 years



CLAIRFIELD TRACK RECORD

DENTAL DEAL SPOTLIGHT

France



was sold to



Groupe Nadia sold one of its subsidiaries, Prodont Holliger, to Acteon, which is backed by Bridgepoint Capital. Prodont Holliger is the leading French manufacturer, and one of the top three in Europe, of dental instruments, mirrors, abrasives, waxes and models. Clairfield International in France acted as the exclusive financial advisor to the seller.

DENTAL INSTRUMENTS

CLAIRFIELD IS A LEADING ADVISOR FOR MIDMARKET HEALTHCARE TRANSACTIONS

JULY 2018 EMEA SECTOR FOCUS: HEALTHCARE

Financial advisor	2018 Rank
Ernst & Young LLP	5
KPMG	7
Clairfield International	11
Translink	15
Lincoln International	16
Citi	16

Source: Thomson Reuters

SELECTED RECENT DENTAL TRANSACTIONS

Germany



acquired



HEALTHCARE E-COMMERCE

Netherlands



was sold to



DENTAL CARE

Netherlands




was sold to




FACTORING SERVICES FOR
DENTAL CLINICS

Netherlands




acquired



DENTAL CARE



France



sold

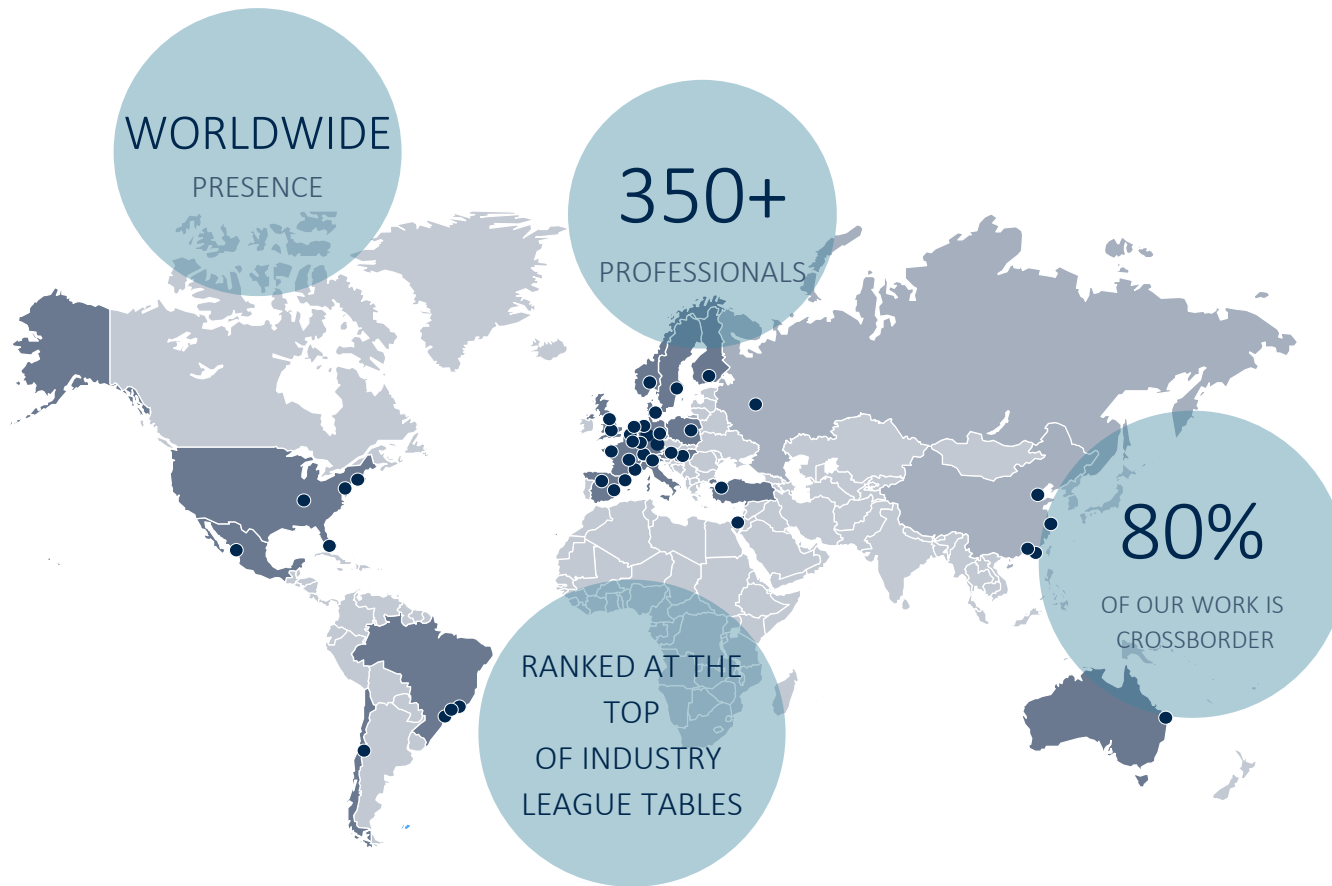
Prodont Holliger

to

DENTAL INSTRUMENTS

CLAIRFIELD – A GLOBAL PARTNERSHIP OF M&A SPECIALISTS



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