SCANNING THE MARKETS FOR VALUE

FOUNDED IN 1989, ALLIANCE MEDICAL HAS RAPIDLY BUILT UP A STRONG PRESENCE IN EUROPE AS WELL AS THE UK. **PETER JARMAN** EXPLAINS HOW THE COMPANY RAISED NEW DEBT FACILITIES EARLIER THIS YEAR TO MEET ITS MEDIUM-TERM GROWTH GOALS.

Alliance Medical is Europe's largest independent provider of outsourced diagnostic services, owning and operating more than 80 static and mobile magnetic resonance imaging (MRI), computer-aided tomography (CT) and positron emission tomography (PET) scanners. The group has grown rapidly over the past two years and now operates in a number of European countries, including the UK, Italy and Spain, and has recently commenced operations in France.

Privately owned, Alliance Medical provides equipment and scanning services to both the public and private sectors, counting among its key clients the National Health Service (NHS), Bupa, Nuffield Hospitals and state-owned and private hospital groups across Europe. In this article, Peter Jarman, Group Finance Director of Alliance Medical, describes how the company raised new debt facilities earlier this year to fund its medium-term growth plans and also provides an overview of the company's pan-European treasury operations.

GLORIOUS GROWTH. Alliance Medical was founded in 1989 by Robert Waley-Cohen following a successful spell in the US, where he co-founded Alliance Imaging Inc (now the world's largest independent diagnostic scanning service provider, with a market capitalisation of $188m). Totally independent of Alliance Imaging, Alliance Medical commenced operations in 1990 with one mobile scanner that was shared between seven hospitals.

Capable of operating on a standalone basis, the scanner, located in a purpose-built trailer, was moved between hospitals overnight and operated as an annex to each hospital during the day, satisfying local demand without the need for each hospital having to make the significant investment needed to acquire its own equipment.

Further scanners were added to the fleet over the next few years and, in 1994, Alliance Medical was approached by Nuffield Health Care Limited to take over the operation of three static MRI scanners already installed in its hospitals. The combination of high demand and ever-changing technology has required a continual high expenditure on new capital equipment in order for the company to be able to meet the increasing demand for diagnostic MRI and CT scanning services in the UK.

Alliance Medical is leading the way in the UK in the diagnosis of cancer with the introduction of the latest technology PET units. The UK's first PET/CT unit became operational in March 2003, with the opening of Alliance Medical's state-of-the-art free-standing diagnostic centre just off Harley Street in London. In the same month, the company started the UK's first mobile PET service, with the introduction of its new mobile PET scanner.

SUCCESS IN EUROPE. In July 1998, we expanded into Europe with our first mobile MRI unit in Italy and rapidly extended our service such that three units were in operation by February 1999. In August 1999, a joint venture was formed with the largest provider of outsourced diagnostic services in Italy, and in May 2001 we acquired full ownership of the Italian business. Today, Alliance Diagnostic srl is the largest provider of outsourced diagnostic services in Italy, providing MRI, CT, mammography, cath lab and PET services from both mobile and static units to both the public and private markets.

In May 2001, we also established AMIS, a European 'interim' scanners division, to address the increasing demand across Europe for the supply of unstaffed mobile MRI and CT units on a short-term rental basis. In late 2001, Alliance Medical formed a new joint venture company in Spain to capitalise on opportunities brought about by the government's restructuring of the country's healthcare system. Success in a number of regional tenders for the provision of long-term mobile MRI services has resulted in the purchase of three mobile units, making Alliance Viamed SL the largest provider of mobile diagnostic services in Spain. Today, the Alliance Medical Group is a pan-European business operating a fleet of 27 static scanners and 62 mobile scanners.

In January 2001, Alliance Medical was the subject of an institutional buyout, in which Bridgepoint, one of Europe's leading mid-market private equity investors, acquired a majority equity stake. At this time, we also raised new debt facilities both to support the acquisition by Bridgepoint and to finance our future growth. We have forged a close relationship with Bridgepoint, which has two nominated non-executive directors on the Board – while they are hands-off in terms of the day-to-day management of the business, it is particularly useful to have the input of experienced private equity investors on the strategic direction of the company.

One of the greatest benefits afforded to us as a result of being private equity owned is access to capital. This, for us, is of fundamental importance, given the growth opportunities available in a market where demand for scanning services invariably exceeds supply, but where scanners generally costs upwards of £1m.

We have found that private equity capital can be extremely beneficial for relatively small companies, like ourselves, with major growth aspirations. In particular, Robert Waley-Cohen notes that: "In the UK, of the 2,300 or so companies whose shares are traded on the London Stock Exchange, over 60% are presently capitalised at less than £50m, and over 70% at less than £100m. With institutional investors currently considering investments in companies at this end of the value spectrum as sub-scale, having a supportive and well-funded private equity investor that understands and supports our business model is fundamental to our ability to deliver on our medium-term strategy."

CAPITAL EXPENDITURE. The provision of outsourced diagnostic scanning services is a capital-intensive business, with scanners typically costing between £1m and £2.5m each. During the early years, we acquired scanners on finance leases, often provided by the equipment manufacturer, thereby gaining access to state-of-the-art equipment with very little capital outlay upfront. As the business grew, however, it became apparent that the medium-term nature of the funding was not matching the much longer useful life of the assets (which can last for upwards of 15 years). Therefore, at the time of Bridgepoint's acquisition of the company, the decision was taken to acquire the existing fleet of scanners outright and to secure a capital expenditure facility from the banking group supporting the acquisition to fund future scanner purchases.

The bank facilities worked well for the company, although given the rapid expansion of Alliance Medical, including one large acquisition in Italy that was funded by additional equity and debt commitments from our shareholders and banks, we very quickly utilised availability under the capital expenditure facility. In order to pursue our medium-term strategy, the company required further debt facilities and the Board decided to seek independent advice on the options available to the company to fund its future growth. The Board appointed Close Brothers Corporate Finance in October 2002 to advise on the available options and, following a period of research, it was determined that the company should pursue a refinancing of its existing debt facilities to extend their maturity, while at the same time raising a new capital expenditure facility to fund medium-term growth.

'HAVING A SUPPORTIVE PRIVATE EQUITY INVESTOR IS FUNDAMENTAL TO OUR ABILITY TO DELIVER ON OUR STRATEGY' *ROBERT WALEY-COHEN, CEO, ALLIANCE MEDICAL*

'THERE REMAINS STRONG APPETITE IN THE DEBT MARKETS FOR WELL-STRUCTURED TRANSACTIONS OFFERED BY MARKET-LEADING COMPANIES' *FENTON BURGIN, DIRECTOR, CLOSE BROTHERS CORPORATE FINANCE*

In conjunction with our advisers, we prepared a detailed information package, including an information memorandum, financial models and a detailed terms sheet setting out our key objectives from the new facilities. The information package was submitted to a number of banks requesting independent, credit-approved proposals for the refinancing, including the new capital expenditure facility.

A GOOD RESPONSE. Following a series of management presentations and detailed Q&A sessions, we received responses from the banks we had approached and, having selected a small number with whom we wanted to work, negotiated a common position. We considered the option of appointing a sole bank to arrange and underwrite the new facilities, but concluded that it would be in the company's best interests to appoint a small club of leading banks, thereby minimising syndication risk on the part of the underwriters and optimising the terms, conditions and pricing for the new facilities.

Following a financial and commercial due diligence exercise and documentation process, the new facilities were signed in May 2003. Our new lending group comprises Bank of Scotland, Barclays, The Royal Bank of Scotland and Société Générale – a high quality group of banks that understands our business and supports our medium-term strategy – and we have access to a new capital expenditure facility that will finance our growth plans through to 2006.

Commenting on the completion of the refinancing, Anthony Sage, a Director in the Leveraged Finance Group at the The Royal Bank of Scotland, the agent bank for the new facilities, noted that: "Raising debt facilities where a significant element is drawn down over an extended period to finance future growth can be challenging – the deal secured by Alliance Medical is testimony to the quality of the business model. Alliance Medical is now well-placed to exploit the substantial opportunities that will be present in its market over the next few years."

MARKET-LEADING COMPANY. A factor we considered carefully at the outset of the refinancing exercise was the prevailing conditions in the European debt markets, particularly in light of the general weaknesses in the European economy. We did find, however, that there was a strong level of demand for the transaction. Fenton Burgin, a Director of Close Brothers Corporate Finance, said: "In spite of continuing difficulties in the wider economic environment, there remains strong appetite in the debt markets for well-structured transactions offered by market-leading companies."

As a rapidly growing company with an increasing share of revenues generated overseas, we are placing more emphasis on our cash management processes. Our working capital requirements are catered for by way of a revolving credit facility, allowing us to offset our credit balances against our borrowings to minimise our interest costs. Our operating subsidiaries operate current accounts locally, monitored centrally at head office, and we sweep surplus cash on a daily basis.

We are also increasingly focusing on our foreign exchange (FX) exposure, given the increasing amount of euro income generated. Our borrowings are largely denominated in sterling, although we do have a small amount of borrowing in euros. The recent strengthening of the euro has been to our benefit, however, we will consider hedging our exchange rate risk during 2004 as our European businesses grow.

We have taken a conservative approach to our interest rate exposure and we entered into a series of interest rate swaps in June 2003 to fix our variable rate borrowings for the next five years. We decided to hedge 100% of our term borrowings, as the rates on offer were very competitive. Time will tell whether this is in fact true, although knowing that the cost of our borrowing is fixed for the next five years reduces uncertainty surrounding our debt servicing costs considerably.

Bridgepoint's support has been fundamental to our development over the past two-and-a-half years and we have grown to the point where we are now a leading operator in the European diagnostic scanning services market. The market itself is changing, in particular in the UK, as the means of delivery of healthcare services changes with the introduction of Diagnostic Treatment Centres, and these changes will create challenges for both the public and private sector service providers.

We are approaching the future with confidence on the basis of strong underlying market dynamics and, with our new debt facilities allied with our supportive private equity backing, expect to be able to take advantage of the opportunities that will exist over the next few years.

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