

VETCARE

# Network Healthcare Holdings Limited

(Registration number: 1996/008242/06) (Incorporated in the Republic of South Africa)  
(JSE share code: NTC) (ISIN code: ZAE000011953) ("Netcare", "the Company" or "the Group")



Netcare Unaudited group interim results  
Conference Call  
19 May 2008



**You're in safe hands**

---

**Operator**

---

Good afternoon and welcome to the Netcare interim results. All participants are now in listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference, then please signal an operator by pressing star and then zero. Please also note that this conference is being recorded. I would now like to turn the conference over to Dr. Richard Friedland. Please go ahead, sir.

---

**Richard Friedland**

---

Thank you. Good afternoon ladies and gentlemen, and thank you for giving your time this afternoon. I'm going to give a brief introduction and then hand over to Peter Nelson. I'm also joined by Jacques du Plessis from primary care who is now taking over the hospital division, and Belinda will be joining us shortly. And welcome to take any questions. So I'll speak for a few minutes, and then hand over to Peter Nelson.

I think that if you look at our results we were more than pleased at the revenue line in terms of very strong growth I both South Africa and the United Kingdom. Our growth in South Africa was 4.7% patient days on an organic basis. If you take the Easter impact out and you now place the results for seven months to April, the growth in patient days was 5.5%. I'm not suggesting that we are changing our guidance and our growth in patient days is going to more than 4%, but we have seen very good growth coming through our hospital division here in South Africa, and we've seen very good growth in the United Kingdom on an organic basis, some 8.6% up. Again that is driven mainly by NHS volumes, both from EPN or pre-choice referrals and also stock purchasing in the NHS market, up by some 180%, albeit off an extremely low base. You'll remember last year our volumes were between 2-3%. So we're clearly on forecast there and we've seen some very strong volumes.

Again we were impacted by the Easter effect in the United Kingdom. If you look at inpatient volumes in the United Kingdom they had only increased by 1%. And if you look at the seven months including April that takes you to 3%. So overall I don't think we're concerned at the top line. I think we've had very good growth in the hospital divisions from a growth point of view, and in primary care we had very good growth at the top line as well, some 32% growth in revenue. This was also driven by more managed care lives at the lower end of the market, some 208,000 lives, an increase in visits by some 6% to 1.8 million, and lots more doctors joining the network. So from a general growth perspective I think we are continuing to see the fruits of our investment strategy and patients accessing our network. It wasn't necessarily as a result of increased GEMS patients through our hospitals. It was

across the board. We did have one of our regions which was not performing as well as two of the others, and I think that let us down in terms of some of the parameters I'll talk about.

When you look at our margins, however, you will see that in primary care we brought on work that was at a lower margin and that the core margin did slip somewhat. That's essentially due to bringing on lower-margin work. It was down by a half a percent. The impact of primary care was great, given that its contribution was substantially more this year. Our margins did slip in South Africa on the hospital side, and I know there have been a number of concerns around that. I wanted to address that because I think we had a number of cost pressures. A lot of people are saying Mediclinic maintained their margin over this period, and why didn't we? Please remember they had nine months of last year and three months of this year. I think we made three significant concessions, one on anaesthetic gasses. We also reduced our tariff for the Minister. We probably had a slightly lower tariff than the rest of the market. We have had some cost pressures, particularly in these three months. And I think very importantly we've had a negative mix. We might have grown our patient days but we have had a negative mix. And if you take the organic volume growth coming through at about 12% of our hospitals, you will take those patient days and take our tariff increase on a cost per event, you'll see that there is probably a negative case mix variant of at least 1.1%. We also found there was a negative case mix variance on our community hospitals. They seem to do a lot less surgical cases than we do through the traditional Netcare network. And we saw a higher increase in day cases this year, all contributing to lower margin work coming through.

Those were some of the factors, besides the once-off numbers that we've spoken about that impinged on the South African numbers at the EBITDA line. I'm confident that we'll be able to recover some of that in the second six months of the year. It may necessitate that we may be going back to the market to increase the tariff back to where it was before we conceded to the Minister of Health which took our average from 7.9% to 8.4%. We believe it's entirely justifiable for this year. In the UK our core margin actually increased, and I'm not referring specifically to the slide. But when you strip out the once-off costs you will see that actually we are more efficient and our margins have improved there. And we remain confident that the UK will meet its targets for the 2008 year.

When I look at South Africa we have a number of challenges at the moment. I think the key challenge for us is a regulatory one. We have submitted our opposition and our comments to the Department of Health on Friday as part of HASA. It represents 94% of the industry. I know that there are some investment institutions that have done so as well. I know that Momentum and Discovery have also objected, as have the South African Medical Association and at least five of the specialist management groups have consulted with council with the view to opposing any legislation. Our strategy on this is obviously to object vehemently and delay its implementation. Our view here is that

there is a very short window for the implementation or passing of these amendments, and it may go a legal route in order to ensure that they're not enacted this year. We've had several discussions with new leadership. We are confident that new leadership coming in understands the critical issues around healthcare in South Africa and are galvanized to finding a solution. And we believe in Netcare that we have an opportunity. We're at the cross-roads; we have an opportunity now to influence that policy before July 1<sup>st</sup> next year. Certainly we've given ourselves till the end of this year together with industry players. We're talking to Discovery and Medscheme on one side and Metropolitan on the other to expand access and affordability in this market.

Our view is that there is a paralysis at centre, that the power has shifted to Thuli House and that effectively government is on auto-pilot. I don't think we would be bullish or at all positive if this government was continuing, and we were dealing with this Health Minister into the future. So we do think that there are solutions to be had. We are well on track to submit a publication and our proposals on the NHRPL process. It's an incredibly detailed process. It has cost the industry some R5 million already, and I'm talking about HASA, in terms of building these models. We are obliged to submit our data. We submitted a model which was accepted, and we're obliged to submit our data by the 17<sup>th</sup> June. You'll remember from the earlier timetable that that is now some months later, so the question of implementation this year or early next year looks highly unlikely. It's still got to be put out for comment, and I think there is a lot more work that needs to be done on it. But we are feeling a lot more confident in the sense that we followed a rational process, one that will stand up to scrutiny by legal or on any accounting basis whatsoever. So I think those are the two regulatory issues that are hanging over healthcare at the moment. As I said I believe we can put solutions out there that reposition private healthcare, and certainly from a Netcare perspective we are hard at work doing that.

I've given you a very broad overview. Just to talk about the United Kingdom. We are on track to meet what we have targeted for this year. I think we've had a good six months. We made a profit after extraordinary items or once-off costs and servicing of our debt. We have put a lot of energy into driving the direct marketing of private healthcare through GPs and also what we call doctor liaison managers, and also in terms of bringing on new consultants and we try to grab market share. Obviously the market is becoming more competitive with Ramsay and Cinven in terms of Spire and the Capio acquisition. But we are confident that we can growth the top line and still extract the kinds of efficiencies that we need. There are a lot of moving parts in the UK at the moment. We're retrenching some 292 finance people throughout the organisation and putting them into a shared service. We restructured the regions to align the PCTs and made more of a regional offering. We're looking at shares services in HR and centralising IT. And obviously we've got to bed down the Nuffield acquisition and ensure that we derive those synergies and convert their fee structure to ours. Remember, theirs was substantially lower and came without VAT as a charity institution.

So I would argue that the United Kingdom has its work cut out for it this year, and equally here in South Africa we will continue to attempt to improve margins by removing a lot of our cost structures, by selling of non-core assets and by focussing very hard on our hospital operations. I think two out of three of our regions are doing extremely well, the coastal region and the north-eastern region. I think we suffered here in Gauteng, but I'm glad to say we're about to make a new appointment there, and I think that that will help recover some of the margin loss that we saw over the first six months. I'm going to stop there and ask Peter to take us through some of the issues. And I've made a very generic presentation. I'm happy to deal with any of the numbers in detail.

---

***Peter Nelson***

---

Good afternoon ladies and gentlemen. At the outset let me just note that the acquisitions which we've made in the six months, and which have increased our base significantly and are very positive for us going forward, do have an impact on the financials in this half. Firstly the acquisition of Community was effective 2<sup>nd</sup> October. We issued 14.2 million Netcare shares for that at a cost of R11.89 per share or a cost of R101 million. And we also took on debt of R171 million plus responsibility for the capex programme of some R53 million. At the take-on of Community we deemed it necessary to impair certain debtors and loans and some of the financials. The effect of that was that it cost us by virtue of the fact that we at that stage accounted for Community as an acquisition, some 46% of that impairment we basically picked up. As time goes forward we might see that is a little less necessary and we can take another view on that later in the year.

On the Linkwood acquisition, this was purchased at a nominal value. We paid R22 million to finance creditors and put another R5 million of working capital in there. And then of course the big acquisition was the Nuffield acquisition. It cost us £140 million. We raised £100 million of debt and used £40 million of our own cash. And then subsequently we sold two of the nine hospitals for £31 million, and those proceeds will only flow in during half two. And goodwill arising on that acquisition was some £18 million. But all in all the acquisitions do have some impact on our balance sheet and on our income statement in the half.

Secondly, on exchange rates and interest rates, we need to dwell on those. Firstly, the long-term interest rates in the UK declined from 5.75% to 5.25% in the period. And as you know we have two swaps, one for years one to ten and another for years 11 to 25. And therefore as interest rates came down these swaps were floating rates to fixed and as a consequence of that we incurred some mark

to market losses. These losses in the main go through equity and the balance sheet as we hedge account them. A small portion, some R16 million, went through the income statement. But the largest portion, some R1.2 billion, went directly through equity, though our statement of recognised income and expenditure. And the point of hedge accounting is to hedge these items over the life of the swaps, and to smooth that out such that at the end of the swaps that figure becomes zero. Now I would expect that as inflation is increasing in the UK that we're probably going to face a turnaround in this interest rate cycle and that these interest rates would move up, and to some extent that position is going to reverse. It is important to note though that it is non-cash flow and as usual the UK debt remains ring-fenced to the UK.

On the cross-currency swaps, in South Africa we still had the balance on the bridging finance which we raised to acquire GHG. And these were fully covered out in South Africa when we acquired GHG. We closed them out at R12.17. At the end of September the exchange rate was R14.03 to the Pound. At the end of March it was R16.08 to the Pound. And accordingly we made quite significant gains on these currency swaps. The asset value which was R188 million at the end of September moved to R388 million at the end of March, and in incurred a R200 million profit on the swap. Now, just so you can follow how this is accounted for, the loans that we're busy covering out the forex on, because those loans converted to weakening Rand we had a R199 million loss on those loans, which were expensed as financial expenses. But the profit we make on the swaps of some R200 million is accounted for in financial income. So if you look at our accounts you will see the big cost and the big income, which effectively is mostly hedged out.

On our income statement, just to comment on a couple of the items, the attributable earnings from associates last year was R15 million. This included our share of Community hospitals as we equity accounted those investments. This year of course the Community hospitals are consolidated and their numbers move above the line, and hence you would expect that the portion that related to them year on year would drop out. And also I spoke about the R8 million adjustments that we made in respect of [unclear] values and our debtors and loans etc. And also we sold Healthshare early in the year, and we didn't have the set of profits from Healthshare that we've had in the past. So you see quite a swing-around on that line, R15 million down to R3 million loss in the half.

Then to comment on the tax rate, the tax rates do appear to be on the low side, but we've got some specific reasons for that. In South Africa we've processed some STC credits, and we also had a reduction in the corporate tax rate. And as you know when that happens you basically calculate your deferred tax liability on your balance sheet. And the liability decreases as a result of the lower tax rate going forward, and that decrease is processed through the income statement as a release or as a

credit, and it gives you some shield against tax. In the UK we did raise some deferred tax assets, some £350,000, because we took a view that we're increasing the [inaudible segment] and the profitability of the UK is up, and therefore these assets can be brought to [unclear].

On the headline earnings per share these are flat as we published them. We have listed a number of non-recurring items, which if one wants to go and look at those individually and make some adjustments is about 4.2c per share aggregate adjustment in respect to these non-core items. And if you look at the headline earnings per share before that we would probably have been in the order of 27.1c per share or 12% up year on year. The balance sheet, particularly the movements on assets and debt, looks quite large from September to March. I must point out that the acquisitions I've spoken about play a big role in that, and one needs to unpack that. But obviously the currency impact alone plays a very big impact. [Unclear] property, plant and equipment, which at September was R26.7 million in total, at March that moved to R32.3 million in total. And some R3.5 million of that is purely due to the currency impact. So what I am suggesting is one needs to understand the impact of that.

The biggest disappointment to us was around the debt on the balance sheet in the sense that the cash flows in the six month period weren't optimal. We had the Easter period that affected us, and certainly because of our change in billing and systems we had some delays with some of the medical aids over that time. And also we're not collecting debt from Ampath at the moment. As we've said, we're in a process of selling that, and I think we've finalised all those terms. It should be finalised by the end of September. But the amounts which they used to pay us in respect to management fees are just being held up and will be settled as part of the total later in the year. All of these things taken collectively meant that our debt did increase quite significantly. But I am pleased to say that the debtor situation turned around very sharply in April, and already by the end of April our debt position was significantly better than that published at March.

In terms of the South African debt position, we were at R6 million and R51 million at the end of March. The Ampath proceeds are yet to come in, but they will be something south of R1 billion when we conclude that towards the end of the year. The cost of this debt is increasing. Last year the debt was costing us on average 8.9%, and the cost of the debt in South Africa because of interest rate increases has moved up to 10.2%. As at the end of March our debt was 78% hedged. And if we take into account the proceeds we expect to receive on Ampath we would say that our debt was 98% hedged. As we stand today we think that that position is comforting, given the uncertainty in the financial markets and in terms of accessing and securing finance. So that is in place and we can move concentrate on our business.

The UK debt position, and to remind everyone this debt was always ring-fenced and remains ring-fenced, the gross debt increased from £1.865 billion at September to £1.971 billion at the end of March. Clearly the acquisition of Nuffield has increased the debt position quite significantly, but that was always understood and accepted. And we utilised some £40 million of our own cash. We were sitting on £78 million of cash at September and we used £40 million of that to finance the acquisition. And we're yet to receive £31 million from the sale of the two hospitals which we have sold. It's important to note that the interest rates were covered from floating to fixed and we still have 5.5 years to run on the financing. And we're not therefore in any situation in the short to medium term that requires us to refinance this debt or which might hold some surprises for us.

Our cash flow generation for the half, the conversion of EBITDA to operating cash flow was a bit disappointing. Previously we've been running at rates of plus or minus 80%, or 77% last year. This year that dropped to 72%. But I have mentioned that that cash conversion was impacted by slow debtors' collections, impacted in turn by Easter and systems of billing and the like. We've increased our dividend declaration from 13c to 14c. It is a reduction in capital. It will be the last time that we pay a dividend via this route. These reductions in capital now mean that our shareholders pay CGT on these proceeds and it complicates their lives quite significantly. And I think that Netcare will in future be reverting to pure dividends in the normal fashion. It is an increase of dividend when in fact the earnings per share appear flat, but we know there are a lot of one-off items in those earnings. We also know that our Health Partners for Life Trust requires certain dividends to meet their debt repayments in their own right. And we know that post March the debt flows and cash flows were significantly improved, and that by the end of the year we expect to be on target with our leverage ratios and de-gearing etc. So we felt we could increase the dividend by 1c.

On the South African side we guided a 14% increase in revenues. We now say 15% to 16%. I think you've already seen that at half year we exceeded that because of our acquisitions etc. so I guess we'll probably be towards the higher end of that. On the operating efficiencies, in Rand terms probably the same sort of levels of EBITDA, although at lower margins. Richard has spoken about the margin squeeze. Some of the things we're doing to recover from that position... but also some of our turnover growth, whether its Community or in primary care or our other businesses, some of our turnover growth is at quite significantly lower margins than we've previously enjoyed. On the capital expenditure we previously said about R650 million. We're now saying about R700 million. We are forced to spend some R60 million on installing generator capacity and building some connections around that to make sure that we've got complete redundancy at our major hospitals. You saw what some of the impact was on our business in the first half. And that number includes some R300 million of expansion capital that we're working on.

In the UK we previously said revenue would be up some 6% to 8% excluding Nuffield. We stand by that guidance, but we are saying now that we have had sight of the Nuffield transaction. The IRFT [?] has approved that without any implications, and accordingly if one rolls the Nuffield revenue for the period February to September into total revenue I would expect the UK to be up some 10% to 12% on the full year. We haven't seen the end of the one-off costs and rationalisation. There is still some integration of Nuffield taking pace, and there's still some more centralisation to take place. And as and when the business can cope with this we might well incur up to another £4 million in rationalisation costs, which will take the total figure to £8 million for the full year. And capital expenditure, we're sticking with the original guidance of some £50 million to £60 million. That concludes what I intended to discuss and we stand by to take questions.

---

***Operator***

---

Thank you very much sir. Ladies and gentlemen, at this time if you would like to ask a question please press star and then one on your touchtone phone. If you then decide to withdraw your question please press star and then two. Our first question comes from Alex Comer of JP Morgan. Please go ahead.

---

***Alex Comer***

---

Hi. I just have a couple of questions on the UK. In this domain if you look at what happened with the NHS the [unclear] in the private sector were down. Now, I was just wondering could you go down the volumes in PMI and self-paid in the UK. And also there is very strong NHS growth through to the end of March. Is that continuing in April and in the early weeks of May, and could you indicate what your outlook is on that front? That's my first couple of questions.

---

***Richard Friedland***

---

Alex, good afternoon. I'm sorry; we're struggling to hear you properly. Repeat. I'm sorry to do this to you, but we struggled to hear the first part. You want to know about the volumes in the UK business.

---

***Alex Comer***

---

Yeah. It looked to me like the volumes were negative in the private sector, given how strong NHS was. And I was just wondering if you could break that down between the self-pay and the insured market.

And also could you give us an indication of how strong the NHS numbers have been post the end of the half year period.

---

***Richard Friedland***

---

The NHS numbers have continued post the half year period. We don't expect it to continue at the same rates of increase that we saw in the first six months, but they have continued. We have seen a decline in self-pay, particularly in our northern regions. I think it's a proxy for the economic climate and the recession that we're seeing in the United Kingdom, and those volumes have fallen off. In terms of the PMI market, that market has been sacked down. But I do urge you that we didn't form part of the BUPA network on ophthalmology. And if you take out that impact of that BUPA ophthalmology... in other words BUPA had put out the network where it was going to include some of our hospitals and not others. We chose not to participate. That PMI market has been reasonably flat; if you include the BUPA, that market has declined somewhat. And that's a contract that will come to fruition at the end of this year. And then obviously we had quite a significant impact on Easter which has recovered somewhat. I think if you take the Easter impact into account I think we were 1% up on PMI cases if you take the seven months. Our view on the NHS is that we're uncertain. But our view is that the volumes should still continue. I think given some of the political pressures that Brown is facing, some of the chaos in purchasing, I don't think it's necessarily going to be pre-choice volumes we're seeing. But I do think there is some pressure on meeting those 18 week targets and we've seen the waiting list come down somewhat. There are an extensive number of people waiting beyond the 18 weeks.

---

***Alex Comer***

---

Okay. And I want to just ask a question in South Africa. Clearly your margins have come down and you talked about the current Health Minister and whether or not she'll still be there in a year's time. It is unlikely. But when you've got rampant inflation which looks like it's going to continue, and you've got constraints on your tariffs, how do you address that going forward to ensure that whoever does come into the Ministry understands the basic economics of the supply constraints?

---

***Richard Friedland***

---

That's a very interesting point. Had we absorbed the NHRPL tariffs the way it was initially envisaged and constructed, we would have made a loss of about 15% as an industry. So I think that's a key

issue. I think we're dealing with some extraordinary factors in our economy at the moment. I think even fuel costs have hit our 911 operations quite significantly, and we're contemplating going back to the market for increases in that division because that has also diluted our margin. And it's a very tight environment. I still believe there are efficiencies to be gained out of our company, and I think that some of the restructuring we did in the first half will bear fruit in the second. But there is no doubt in my opinion that we need redress for the tariff line to compensate us for inflation which is rapidly approaching a double digit.

---

**Alex Comer**

---

Okay, thanks. I don't suppose there has been any action on importing any nurses, has there?

---

**Richard Friedland**

---

We are going across... the team is leaving to go to India in June. We are looking to import quite a number of nurses, mainly in our coastal regions where we have a lot of vacancies and where we feel that there would be a good fit. There's a team leaving in June to do the various initial interviews. They've still got to pass the South African Nursing Council exams. We put a nine month period on the first nurses arriving in South Africa. But again it's contingent on a whole range of issues. But you know we've got a licence from Home Affairs and we'll bring in as many as we can.

---

**Alex Comer**

---

Okay, thanks.

---

**Operator**

---

Ladies and gentlemen, a reminder that if you'd like to ask a question please press star and then one now. We'll just pause a moment to see if there are any further questions. Gentlemen, we have no further questions. Would you like to make some closing comments?

---

**Richard Friedland**

---

Yes I think I would like to make some closing comments. I think I know that the margin in South Africa has worried a number of people. We understand that. We're hard at work at it. I think the working

capital went out, and I know that was a concern. We're already back on track, and I'm very confident that that will fall in line. But we're hard at work in terms of correcting some of the issues that caused this margin slip. I think our new hospitals, Albalito and Blaauwberg, together with the Community Hospitals, further diluted the margin. And we did have a negative mix as well. All of those together with our concession on tariffs has resulted in this kind of situation we find ourselves in. And the moving parts of that which we're able to change we're certainly hard at work to achieving. And obviously we're happy to take some of your calls at any stage on any of these things. Thank you very much, ladies and gentlemen.

---

### ***Operator***

---

On behalf of Netcare that concludes this afternoon's conference. Thank you for joining us. You may now disconnect your lines.

***ENDS***

#### **DISCLAIMER**

Netcare reserves the right to make changes to documents, content, or other information in this transcript without obligation to notify any person of such changes.

In the conference calls upon which Netcare's Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN THIS TRANSCRIPT IS A TEXTUAL REPRESENTATION OF THE NETCARE CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES NETCARE OR THE PUBLISHER ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED IN THIS TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE NETCARE CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2008, Netcare.