



# **2018 Full Year Results**

Thursday, 24<sup>th</sup> May 2018

## **Introduction**

James Arnold

*Head of IR, Mediclinic International*

Thank you, and good morning everybody. Thanks very much for joining us. Before I hand over to Danie and Jurgens, who will take you through today's results presentation, just wanted to quickly do the formalities, and point to slide two, with regard to the forward-statements. And at the end of the presentation, we will take questions from the line and from the audio webcast. And we'll moderate that, so we will get your questions seen to. If we don't get through all of the questions, please do follow up with me at the end of the presentation. On that note, I'll hand over to Danie. Thank you.

## **Mediclinic International 2018 Full Year Results**

Danie Meintjes

*CEO, Mediclinic International*

Thanks, James. And let me start by welcoming all of you on this audio webcast, and also those on the conference call. Thank you for joining us this morning. As you know, this will be my last results presentation before I retire as CEO, and when Dr Ronnie van der Merwe will take over from 1<sup>st</sup> June. I will also introduce Ronnie to you at the end of this presentation.

So to start with, on slide five, just a brief summary of our business. The demand for quality healthcare services continue to grow, driven by the well-known factors, amongst others: ageing population, disease burden, new technologies, and consumerism. With our well-established international footprint in diverse markets, we believe Mediclinic is well-positioned to benefit from this growth.

Our strategic approach is to use our international scale to the benefit of the Group. We have made good progress to standardise back office systems, and we have invested to build capacity and capabilities in our International Data Warehouse, and the Analytical Teams. We've unlocked meaningful synergies via our international procurement approach, and we are in the process to expand this further.

The culture of sharing best practices – whether it be administrative or clinical – is well-embedded in our Group. A good example is the support that the Swiss Oncology Team gave to our Mediclinic Middle East team, when they commissioned the City Hospital's Cancer Unit. The same will be done when they commission the Mediclinic Airport Road Hospital in Abu Dhabi, when they open a comprehensive Cancer Unit.

I am particularly proud of what we have achieved as a Group over the more than three decades. I am particularly proud and confident that we have built up a competent and experienced International Management Team, functioning in a well-embedded, value-based culture. I have no doubt that we are well-positioned to deliver long-term value to our shareholders.

Now, to the summary of this year's financial results. I'm on slide six. On an adjusted basis, we were marginally ahead of expectations, as reported at our trading update last month.

Revenue was up 4%, EBITDA up 3%, and a Group EBITDA margin of 17.9%, with earnings per share up 1%. Jurgens will unpack the detail of the numbers on a Group and a divisional basis. I will deal with each of the operational divisions in detail later, but at the high level. As you know, Hirslanden faced two regulatory changes that impacted the business during this year. Firstly, the new TARMED tariffs, implemented from the 1<sup>st</sup> of April 2018. And secondly, the evolving changes related to the lower tariffs of the less complex day surgery cases, which was introduced during this – last year. This led to a lower EBITDA margin, in line with expectations, of 18.3%. Southern Africa performed well in the second half of the year, supported by effective cost management, leading to a slight increased EBITDA margin of 21.5%, ahead of expectation. And in the Middle East, we were pleased with the strong second half performance of the Abu Dhabi business, clearly now moving in the right direction, following the actions that we took. This, combined with the continued good performance of the Dubai business, led to 100 basis points increase in the EBITDA margin at 12.7%, again, ahead of expectation. Spire financial contribution was impacted by exceptional provisions for liabilities, mainly related to the well-documented Eoin Patterson[?] case, and the closure of a specialised Cancer Unit.

Finally, I can report that trading so far, in the new financial year, is in line with our expectation, and guidance therefore remains unchanged. I will now hand over to Jurgens, who will take you through the detailed financial results. Jurgens?

## **Financial Results**

Jurgens Myburgh

*Group CFO, Mediclinic International*

Thank you, Danie, and good morning everyone. And thank you for your time this morning. And starting with financial review, with an overview of the income statement, I'm on page eight of the presentation.

Group revenue is up 4% year over year. The increase was due to improved second half performances in Southern Africa and the Middle East divisions, offset by the weakness in Switzerland, where the second half was affected by the evolving changes in the market and regulatory environment. Our full year adjusted operating profits and margins were impacted by revenue shortfalls in Southern Africa and Switzerland, but at the same time, helped by our cost management and staff efficiency programmes. Adjusted depreciation and amortisation was up 5%, to £145 million, in line with the continued investment programme, expanding the asset base to support growth, enhance our patient experience, and also improve clinical quality.

Our net finance costs benefitted from the refinancing of the Swiss debt in 2017, about halfway through the year, and interest received on surplus cash balances in Southern Africa.

Excluding exceptional, non-deductable charges, the normalised effective tax rate was 20.8% for the year, increased by the high proportion of contribution to profit in the Southern African operations. Our investment in Spire is accounted for on an equity basis, recognising the reported profit after tax, for Spire's financial year, to 31<sup>st</sup> December 2017, which is materially impacted by a number of exceptional charges, as already alluded to by Danie earlier. So our

income from associates was £2.8 million for the year. Adjusted earnings were up 1% to £221 million, with adjusted earnings per share up 1% to 30p. Excluding the impact of Spire's exceptional charges mentioned earlier, adjusted earnings per share for the period was up 5%, at 31.3p.

Turning the page to a further analysis of Group revenue. You'll see here, Hirslanden revenues were up 1.8% from flat inpatient revenues, and an 8% increase in outpatient revenues, which now contribute around 19% of the division's total revenue. Revenue was down 1.2%, if you were to exclude the acquisition of Linde, which happened in July last year. Following a first half in which patient volumes were impacted by the timing of Easter and other public holidays, the Southern African division delivered an improved and stronger than expected second half performance. Despite a continued weak macroeconomic environment, stable medical insurance membership and certain funder interventions, revenue in Southern Africa increased by 5% to just over 15 billion rand. After reaching an inflection point, the second half revenue in the Middle East division increased by 6% comparatively, and by 12% sequentially.

Over the page we show the revenue bridge year over year. Some further analysis on that. You'll see here the positive constant currency contribution from Switzerland and Southern Africa, as well as Dubai. Also the tailwinds from currency movements, predominantly from the rand-pound sterling exchange rate. Also important to note on this graph, is the reduced offset from Abu Dhabi. Last year this time, there was a - that was a negative contribution of £64 million, and as you'll see there, for this year it's 16 million. In fact, on a like for like basis, excluding units that were either sold or closed, Abu Dhabi showed a marginal year on year growth. Further, the positive momentum in the second half of the year in Abu Dhabi through a positive contribution of £8 million, versus a £24 million decline in the first half, in constant currency terms.

Over the page, on page 11 of the presentation. Hirslanden's adjusted EBITDA decreased by 7% in FY18, to 318 million Swiss francs, with the adjusted EBITDA margin decreasing to 18.3%, from 20%. This reflects the impact on revenue of changes in the market and regulatory environment, as well as the continued investment costs relating to Hirslanden 2020 strategic programme, offset by the benefit from cost management programmes and efficiency savings. Southern Africa's adjusted EBITDA increased by 6% to 3.2 billion rand, resulting in the adjusted EBITDA margin increasing to 21.5% from 21.2%, as the ongoing shift in case mix with[?] medical versus surgical cases and lower patient volumes were more than offset by cost management and efficiency initiatives. In the Middle East, the FY18 adjusted EBITDA increased by 9% to 397 million dirhams, following a strong second half operating performance. The adjusted EBITDA margin was ahead of expectations, increasing to 12.7%.

Over the page, on the earnings per share bridge. Adjusted earnings per share was up 1% to 30p, reflecting good contributions from Southern Africa and the Middle East. The contribution to earnings from the Middle East is of course pronounced, due to the lack of company taxes in the UAE. Excluding the impact of Spire's exceptional charges mentioned earlier, adjusted earnings per share for the period was up 5%, at 31.3p.

Turning then to the balance sheet. On the balance sheet, you have firstly, the currency had a headwind impact on the numbers, whereas on the income statement, as I mentioned earlier,

it was a tailwind. The fixed asset base included the increase of £220 million on capital projects fixed asset position in line with the continued investment programme, expanding the asset base to support growth and enhance patient experience and clinical quality. In addition, the closing balance increased by £140 million, as a result, largely, of the Linde acquisition.

In line with the requirements of IFRS, the Group performed an annual review of the carrying value for goodwill and other intangible assets at year end. In Switzerland, the changes in the market and regulatory environment affected key inputs to the measurement process that gave rise to impairment charges against goodwill and indefinite life trade names, of £300 million and £260 million respectively. The impairment charge is non-cash, and excluded from adjusted earnings. Remaining trade names will be amortised from FY19 onwards.

As part of our year-end review of nine financial assets in Hirslanden, an impairment charge of £84 million is recognised against properties. At 30<sup>th</sup> September 2017, at the half year, the market value of the investment in Spire was below the carrying value, and an impairment test was performed. In particular, the Group adjusted the value in use calculations for the guidance announced by Spire in 2017, about the 2017 financial performance, and the related impact on short to medium-term growth rates. And we revisited the other key assumptions in this context. As a result, at that time, an impairment charge of £109 million was recorded against the carrying value. At year end, a further test – impairment test was performed, and hope for the impairment was recognised. In October 2017, the Group completed the refinancing of Hirslanden's secured long-term bank loans, with a 25 basis point reduction in the cost of debt on a like for like basis, and an extended maturity profile until at least 2023. The new facilities totalled 2 billion Swiss francs.

Net debt to EBITDA at a Group level remained in line with last year, at 3.3 times leverage. It was also monitored and managed at provisional operating levels, in line with the principle of responsible leverage, with no cross guarantee or cross default between the different geographies.

Over the page on 14. Cash flow continues to be a strong focus in the Group, as well as in the broader Group as well. Operating cash generated is used to fund expansion initiatives, driving further growth, with strict hurdle requirements. I'll discuss in the individual sections, the reason in Hirslanden and the Middle East, for receivables build-up.

Turning then to capital expenditure. In FY18, the Group invested £138 million in expansion capital projects and new equipment, and £107 million on the replacement of existing equipment and upgrade projects. Hirslanden CapEx reduced by some 27% year over year, due to increased focus on capital allocation. The division continues to invest in Hirslanden 2020. In Southern Africa, the total number of licensed beds increased marginally during the year to 8131, with no new build plans currently envisaged. The major component of the expansion capital expenditure was, and remains, the Mediclinic Parkview Hospital in Dubai. The hospital is expected to be completed ahead of schedule, and on budget. In FY19, the Group expects to invest £163 million and £126 million on expansion and maintenance CapEx respectively.

Turning then to the detailed analysis of Hirslanden, on page 16 of the presentation. Hirslanden revenues were up 2% year over year. The income statement includes Linde, which was consolidated effective from July 2017, and delivered a good operating

performance, following its successful integration. In the current year, Linde contributed some 52 million Swiss francs to revenue. So excluding Linde, revenue was down 1.2% year over year. Underlying revenue was impacted by the timing of the Easter period, a subdued summer market, the continued change in the insurance mix, and as Danie mentioned earlier, the implementation of the TARMED tariff adjustment from 1 January 2018, and the evolving outmigration of care initiatives. That became effective in four additional cantons, including Zurich, from 1<sup>st</sup> January this year.

The gradual insurance mix change continued, with a 10% increase in general insured patients, and a 3% decline in supplementary insured patients. This was, however, exacerbated by the inclusion of Linde, which has[?] an approximate 70% generally insured patient mix. So if you were to exclude Linde from that number, the growth in generally insured patients was 3%, and not the 10% as I reported earlier.

We reacted to the reduced volumes and changing regulatory environment by addressing our cost base, and improving efficiencies. This was done off a high base, given the good FY17 we had. And therefore, the benefit of the restrictive [inaudible] targets and reduction of labour cost became effective from the summer onwards. The annualised effect of cost savings will be reflected in the new year. [Inaudible] includes approximately 5 million Swiss francs for acquisitions made during the year, and further reflects the ongoing capital investment made in the business. Operating expenses continues to absorb the ongoing cost of rolling out Hirslanden 2020 and Hit[?] 2020 in particular, and other corporate initiatives at around 10-15 million Swiss francs per annum.

The refinance of the Hirslanden debt facilities, as I referenced earlier, reduced the credit margin by 25 basis points, and gave rise to lower amortisation of capitalised finance cost. The effective tax rate is skewed by the one-off impairment across the portfolio. The adjusted effective tax rate is approximately 20%, which is in line with prior years. Cash conversion was impacted by a build-up in receivables, due to changes in billing process in a number of our larger hospitals. We continue to target 100% conversion. As discussed earlier, we reduced our capex spend in Hirslanden, and target to keep this new number constant in FY19. FY18 includes 16 million Swiss francs for Hirslanden 2020.

Hirslanden continues to adapt to its business model, to address the trends in inpatient and outpatient activity, driven by the evolving regulatory environment in Switzerland, and the ongoing insurance mix change, whilst returning excellent clinical performance. The continued investment in the Hirslanden 2020 strategic programme is part of the long-term strategy to adapt to this changing environment, whilst also delivering cost savings and operational efficiencies for the division over time. The pace of regulatory change, and its impact on the business continues to evolve, and we are monitoring it closely to adapt accordingly.

In FY19, Hirslanden expects modest revenue growth, supported by an increase in average bed capacity for the year, largely related to Linde. As a result of the regulatory and market trends more than offsetting the benefits of cost savings and efficiency initiatives, the FY19 EBITDA margin is expected to contract by around 100 basis points from FY18.

Over the page then, to Southern Africa. In Southern Africa, revenue was up just over four – over 5%, slightly ahead of expectations, due to an improved second half performance. Volumes for the full year were impacted by a generally continued weak macroeconomic

environment, fewer ordinary working days, funder interventions, and increased competition. In the second half of the year, volumes were up 0.5% comparatively. The increase in revenue per bed day was largely due to inflation, and the mix change in the business. All credit to the local Management Team, as they reacted swiftly to the volumes, and implemented an extensive cost management programme that included headcount freezes, staff efficiency measures, corporate and administrative cost saving. The result was an increase in the EBITDA margin, to 21.5%. In line with our commitment to quality care, we expect to continue to invest in resources, and repairs and maintenance, and thus deliver over the medium term, an EBITDA margin broadly in line with previous years. PNA[?] increased by 7%, to 496 million rand, mainly because of an increased spend on medical equipment. The effective tax rate was in line with the expectation, but up from last year, which included a provision for deferred tax on an assessed loss not previously recognised.

In FY19, the division expects there to be stable medical insurance membership, and no forecast increase in big capacity. FY19 revenue growth will be driven by an expected increase in bed days sold, of 1-2%, largely as a result of an increase in productive days compared to the prior year, combined with tariff increases broadly in line with inflation. As mentioned, the medium-term EBITDA margin from Southern Africa is expected to remain broadly in line with previous years.

Finally then, on the Middle East. The Middle East division increased revenues by 1% on a reported basis, and by 4% when excluding the units that were either sold, or identified for sale or closure, in the current and comparative period. Mediclinic City Hospital, with the north wing extension that houses the comprehensive Cancer Centre, and Al Jowhara Hospital in Al Ain, showed good growth that beat expectation. The Abu Dhabi hospitals and clinics has, and will continue to benefit from measures implemented during this financial year, to align the business and operations with Dubai, including filling doctor vacancies and implementing a targeted insurance mix change. The rebranding of the Al Noor Hospitals and their clinics to Mediclinic was completed in FY18. And as a result, the Al Noor brand name recognised as part of the combination was fully amortised.

Trade receivables continued to increase during the year, and especially during the second six months, as revenues picked up. The good news is that the charge for provision for impairment of trade receivables has reduced year over year. And we forecast to reduce this number even further in the coming year. The increase in trades receivables led to a decline in cash conversion, which is under continued focus, and has already yielded good results in collections, during March and April.

In FY19, the Middle East division is expected to deliver revenue growth in the low double-digit percentage range, reflecting the underlying operating performance of the business, and additional bed capacity coming online in the second half of the year. Please note though, that this includes the adjustment for the adoption of IFRS 15, and as a result, certain operating expenses are reclassified and set off against revenue. On a pro-forma basis in FY18, we'd expect that offset to gross revenue to be approximately 84 million dirhams. The EBITDA margin of the existing operation is expected to increase by around 250 basis points, and to continue improving year over year, to around 20% in FY22. As a result of the early opening of Mediclinic's Parkview Hospital, and the updated schedule for the planned upgrade and expansion projects in Abu Dhabi, the ramp-up cost associated with these projects are

expected to offset the margin of the existing business by around 250 basis points per annum, between FY19 to FY21, reducing thereafter.

With that I will hand over to Danie, to go through the operational reviews.

## **Operational Review**

Danie Meintjes

*CEO, Mediclinic International*

Thank you, Jurgens. I'm on slide 20 now, the Hirslanden operational overview. We are very proud of Hirslanden's position as the leading private hospital group in Switzerland. The division is, however, as Jurgens referred to it, having to adapt to the current market and regulatory environment. As we reported at the half year results, lower occupancies were driven by a quiet summer period, as well as the evolving regulatory landscape. Outmigration is a reality in Switzerland now, with lower tariffs for less complex day surgery cases. It is a complex and a multi-dimensional issue, but we are actively working on a bespoke strategy per hospital, to mitigate this as effectively as we can.

The Hirslanden 2020 strategic programme is ongoing, and just to remind you, the programme has two focus areas. The first is focused on growing the outpatient business, on how to enlarge the Hirslanden's footprint, and how to offer a better network of Hirslanden facilities. This now includes the finding of the best solution to address the outmigration of care trend, as well as how to incorporate this in the broader outpatient strategy.

The second part of Hirslanden 2020 is to simplify, standardise and centralise mostly back office processes and systems, including the standardised ICT solution. It is being rolled out in a phased approach, and I'm happy to report that the Zurich hub – including two large hospitals, and a corporate office – effectively switched over to the new system on 1<sup>st</sup> April, and we were very happy with the result of that. We have already fully integrated the recently acquired 115-bed Linde Hospital. We completed the rebranding, and I'm pleased to report that Linde has contributed positively to Hirslanden. Jurgens referred to the increase in the insurance mix. And he also referred to it, that it was mainly impacted by the inclusion of the Linde Hospital, that has round about a 70% general insured mix.

Over to slide 21, Southern Africa. As you know, we have a leading – we are, is a leading provision of private healthcare in South Africa, for over 30 years now. And again this year, the team performed well, despite the current macro and political backdrop, and with no growth in the number of medical insured life. Volumes increased in the second half of the year, following the slow start in April last year, due to an increased number of public holidays. Jurgens referred to the 6.7% increase in revenue per bed day. It is worth mentioning that we are seeing an upward trend in our case mix index, and an increased usage of the High Care and the Intensive Care Units, supporting the higher income per bed day as a result of the higher acuity. The Mediclinic Southern Africa team did a magnificent job to manage the costs across the business, while still maintaining high patient satisfaction scores, as reflected in the Discovery Health list of top 20 hospitals, as well as in our [inaudible] patient satisfaction scores as we measured it.

As a result of the cost management, the EBITDA margin improved, as Jurgens referred to it. Also just to emphasise, although cost and margin management are important, and a key focus, we are not prepared to risk clinical quality, or our brand reputation, to protect margin. We always strive to keep a healthy balance, and as Jurgens mentioned, we will invest more this year in areas of clinical focus, and would therefore expect the margin to remain around 21%.

In terms of capacity growth, you will see that in the annexures, that there is a pipeline of small expansions of existing hospitals. Given the current market, we have to be diligent with how we invest in additional beds over the next two years. That said, there are opportunities for growth across the continuum of care. We are building a new hospital in Stellenbosch, as we reported, and that is well underway. The facility will supplement the existing hospital in Stellenbosch, and will be commissioned towards the middle of next year, that is 2019. We hope to conclude the Clarksdorf[?] acquisition this year, whilst we await the Competition Tribunal approval. But as such, we have not included anything in our guidance for this transaction.

To address the outmigration trend, also in South Africa, we are busy with the roll-out of six day clinics, as per the annexure, that will open in FY19 and 20. And the Intercare Primary Health investment will further support our outmigration strategy in Southern Africa.

On the regulatory front, there's not meaningful issues to report at this stage, but we await the HMI provisional recommendations, which are due to be published, actually, next week

Over to slide 22, Middle East. As indicated by Jurgens, our Middle Eastern division performed very well, especially during the second half. The Dubai business continued to perform well, and it is evident that the various actions taken in Abu Dhabi are having a successful impact on the business, enhancing the foundations for further growth.

The strong revenue growth in the second half was supported by the removal of the PICA[?] co-payments in Abu Dhabi as of April last year and the strategy implemented to reduce our exposure to basic insured patients in Abu Dhabi. You can clearly see the impact of this – of this patient mix in the graph at the bottom right of the slide. With the PICA patients, those out and in-patients increased in volumes dramatically over the year. Enhanced insured volumes increased in the in-patient environment, and the out-patient trend improved in the second half of the year.

We have divested several non-core assets to focus on our core business; we will still have capacity in the existing facilities in Abu Dhabi and [inaudible] for further growth which should have a leverage effect on our EBITDA as we continue to improve the quality of revenue. In Dubai, capacity is well utilised and for that reason we invested in the 182 bed Park View hospital. The project is six months ahead of schedule and the hospital will now open in October this year. The team is on track and all the key positions are full, including the initial core doctor team. The hospital will be opened in phases, with around 100 beds to be opened in October this year, and some 80 deployed doctors during that phase.

We are also proceeding with the building of the dedicated comprehensive cancer unit at the Mediclinic airport[?] [inaudible] in Abu Dhabi, having redesigned the plans from those that we inherited at the time of the combination.

That concludes the operational overview. To conclude on slide 23, key priorities. We will continue with our patient first strategy, ensuring high quality care both from a clinical and from a patient experience perspective. The affordability of healthcare in the long term is important and for that reason we need to stay effective and efficient. We need to deliver value for money healthcare. We want to grow the business, and therefore evaluate all opportunities, whether it be existing units, additional units in existing divisions or new territories.

We are also acutely aware of the changing delivery models in the healthcare, and we are carefully expanding up and down the delivery continuum. The investment in Intercare and the Hirslanden 2020 outpatient focus are practical examples. We realise that we are in the people business. To be successful we need to continue invest in our people and to equip them to deliver on the promise of expertise you can trust. Similarly, we need to maintain our facilities and equipment in a careful, planned and cost-effective way to ensure that we remain relevant to our patients, doctors, funders and government.

Then finally we do all this as a global integrated group leveraging the benefits of international scale and expertise which enables us to strengthen our unique position as a leading international healthcare service group. I conclude with that, and as said in the beginning I will now hand over to Ronnie before Jurgens and I will take the questions over the slides. Thank you, Ronnie.

### **Brief Comment**

Ronnie van der Merwe

*Chief Clinical Officer, Mediclinic International*

Thank you, Danie and thank you, Jurgens, for a well-structured presentation. And good morning to everyone. I really don't want to take up any more of your precious time today and will therefore just make a few short comments.

I've spent my entire career on healthcare, and it's safe to say that I'm actually quite passionate about it. I started out in the discipline of anaesthesia and intensive care, followed by a few years in the world of medical insurance. And then I joined Mediclinic where I was exposed to many different aspects of the business over a period of 19 years. For most of that time I was an integral part of the executive management team that drove the strategy of the group. I'm very proud of Mediclinic and its people for what has been achieved over time, and I consider myself very privileged to take over the leadership role. I'm confident that together with our strong senior executive team – that I will be able to bolt on the experience that I have gained over the years. And I look forward to working with the team in taking the business forward.

Danie, I would like to take the opportunity to thank you for your efforts in serving Mediclinic. You've made a huge contribution in developing the organisation over a period of 27 years. I wish you very well as you embark on this new phase of your life. And on a personal note I would really like to thank you for your support during this handover period. It's highly appreciated.

In closure, I look forward to meeting many of you at the capital markets day next month in Switzerland. This will be an opportunity for us as senior executive team to provide you with a deep dive into the operations of the business.

And with that I'm going to hand back now to Danie and Jurgens, who will deal with the question and answer section of the presentation.

**Danie Meintjes:** Thank you Ronnie, and from my side I wish you well. And then over to you. Q&A.

**Operator:** Thank you.

**Danie Meintjes:** The line's open so just state your name and then we will respond to your question. Thank you.

## Q&A

**Operator:** If you would like to ask a question over today's conference, please signal now by pressing \*1 on your telephone keypad. That's \*1 to ask a question. We will now take our first question from Kane Slutzkin from UBS. Please go ahead.

**Kane Slutzkin (UBS):** Good morning, gents. Just a couple of questions please. Just from Switzerland, I mean, obviously, you've highlighted all the sort of challenges you face there. I think the market will obviously be quite interested in hearing how you think you're going to go about actually generating revenue growth. If one considers that ex-Linde you were down 1%. And following on from that clearly your margins are going to be under pressure from patient mix. And you mentioned in the guidance that you were looking for 100 bps alone this year. But you do think that's going to recover when [inaudible] could you maybe just give us some colour as to what gives you confidence in that statement in terms of driving – in terms of improving margins subsequent to 2019?

And just on the UAE, if you could just sort of maybe update us. I mean obviously when you acquired Al Noor[?] you spoke of synergies between Dubai and Abu Dhabi for a cool, I think it was 75 dirhams or somewhere round there. And obviously you've had a lot of issues along the way which are well documented. But now that you've had time to sort of fully settle and maybe recover somewhat, has anything changed in that regard? Have you identified anything in the coming years that you could sort of extract now that you've got a better handle on the business?

**Danie Meintjes:** Kane, Danie here and [inaudible]. You refer to Switzerland in terms of revenue growth and margin under pressure and what we will do. I think the first thing that I want to remind you is that Switzerland is a saturated mature market. So with the existing facilities we've never seen exceptional growth before, so capacity was always well used. I think the challenge that we face now is the evolving, very difficult to predict what we broadly term the outmigration of care, which is effectively a much lower price for the less complicated cases. And for that reason, I can give you the assurance the local management including us are really working hard on specific solutions for each one of the hospitals. I think we referred to it earlier on.

If you think of the In Park[?] hospital where we had this additional facility right next door, that has been rejigged, offering a high-end day-care facility where we can optimise patient

experience and lower the cost. In some of our other hospitals we will not have that luxury to have a closely located facility, and if the occupancy is slightly lower, it is actually better to rejig the hospital with dedicated patient activity, patient flows, to bring efficiencies through and to be very hard on the cost management. Now those are all in the mix to look at each one of the hospitals. At – close to St Ana[?] – is that correct? At Lucerne we're building an outpatient facility that will include an outpatient surgical unit. But we will not just jump on outpatient surgical unit. So cost efficiency, making sure the patient activity is properly tracked and efficiently managed, will be the key activities.

With a lower tariff, very difficult to maintain margin. That is why we guide the way that we guide. But there is a lot of activity. It's complex. We need to get the doctors on our side. Because the doctors' potential income or real income based on the lower tariff for these surgeries are much lower. And some of the well-established doctors might just take an attitude to say I'm not going to do this work at the lower tariff. And our work is to get the doctors to buy into the strategy and make them realise it's much better to capture and feed those patients.

On a personal note, I do believe the tariffs are lower than what is reasonable. It will also have an impact on the Cantonal hospitals. And hopefully over time this thing will rebalance itself to a more realistic price point. So that is Switzerland. Do you have anything to add?

**Jurgens Myburgh:** Yeah, perhaps from my side Kane – and I think Danie said so as well, is that you know, Switzerland has been and is a mature and saturated market. So you have to invest to grow and we will continue to invest to grow our business there. You can see in the CapEx numbers there that we continue to include expansion CapEx to grow our business. But recognising that we have the leading private healthcare franchise in that market.

And so maintaining our facilities, continuing to recruit the best doctors that we can and then working with those doctors on improving our insurance mix, improving our acuity – these are the sort of things that we've been doing for years and will continue to do. [Inaudible] is what it is and we've been very transparent about the guidance of the impact of [inaudible] in our business. And in outmigration of care manifests, in addition to a couple of other things, in a reduction in volume. So the primary reaction to that would be to address the cost base, which we have done. As I indicated earlier, we haven't seen the annualised benefit of that coming through. And then over time as Danie indicated, you would have reacted more structurally to what outmigration represents.

But to be honest, and we say so in the results announcement, that this regulatory environment continues to evolve. And so we will react to that, probably in a hybrid fashion initially, and then to a more structural final position eventually. In addition to all of this, as I said, we continue to implement the Hirslanden and particularly Hit 2020 programme and other corporate initiatives which will come to an end in a couple of years' time. And we would look to obviously reduce the cost associated with that and also have the benefit of the improved efficiencies coming out of that.

**Danie Meintjes:** In terms of the UAE – and I'll be – try to be short with the answer to take more questions – just a general remark, yes, the strategic decision to acquire Al Noor, as I said so many times, I'm still happy that was the right strategic decision. Yes, that was an unexpected headwind; but the great news is, we turned it around. And to come to your

question, the fixed cost of running the combined business – I'm very happy that that is under control. The reality is that the current capacity in the existing hospitals in Abu Dhabi, there's still capacity. So as we grow that capacity, we will see a leverage effect based on the central fixed base component. There's obviously a variable cost involved as well.

In terms of synergies, the team did well by centralising, standardising, based on our broader philosophy. If I just think of the lab service that we consolidated to two major labs and one further lab, and our aim, making it much, much more cost efficient – so I'm very positive that we are well positioned. It's a growing environment in terms of the population; it's a stable environment, and we've got a very good name in the market. And the regulatory connectivity between our senior leadership and the regulator in Abu Dhabi improved dramatically, which gives me a lot of confidence going forward. I hope that answers your questions, Ken.

**Kane Slutzkin:** Great, thanks. Thanks gents.

**Operator:** Next question comes from James Vane-Tempest from Jefferies. Please go ahead.

**James Vane-Tempest (Jefferies):** Yes, hi. Thanks for taking my questions. I just have a couple if I can, please. Just on Switzerland, you've clearly identified and disclosed the impairments. Just wondering if you can give us some colour on what those assumptions were which were changed. I'm just curious given the magnitude of the write down on tangibles. And then also actually on the fixed assets on the property itself. So I think that would be helpful to try and understand that.

And then secondly just on Switzerland, you talk about how CapEx is going to be down 20% but at the same time investing in Hirslanden 2020. Just wondering the reasons for the decrease. Is it anything to do with capacity decisions or is it timing? And that would be helpful as well. Thank you.

**Jurgens Myburgh:** James. So on the impairment side, firstly just recognising and realising that the operational performance of the business is in line with our expectation. And as I said at the call in April when we first highlighted this is that the impact of what we're impairing is really as a result of what we've been talking to the market about, you know, since November of last year, which would be the markets and regulatory impact on the business, and in particular on the cash flows of the business. But in addition to that, and as you know, if you look at the broader market, and the assumptions that go into the value in use calculation, sometimes small changes to some of these assumptions could have a material effect on the outcome of the valuation.

So first and foremost would have been the cash flows in the discreet period, but also the assumptions that relate to the calculation of the terminal value, or value in use. And then we also increase the discount rates of the valuation. And the answer is similar in respect of the property impairment as well. It's not a different answer; it's just a different level of impairment test. So we would test at a Hirslanden level for the intangible assets and then lower down at an individual CGU level in respect of the non-financial assets. But the root cause is not different; it's exactly the same answer.

In respect of CapEx, we're not projecting it to be down, it is down 20% already in this year. And so that's a reflection of what I've been talking to investors about is that you know, clearly if you find that the environment is putting pressure on your operating cash flows, you have to

react to that, and we have. This is discretionary CapEx and that we've either been able to – that we're prioritising. Let me put it that way. So we continue to spend both in terms of repair and maintenance as well as maintenance as well as expansion. So we're still spending money; I think we're just prioritising and scheduling it differently to make sure that we recognise the impact of the broader environment on our operating cash flow and as a result, managing the free cash flow of the business.

**James Tempest:** That's helpful. Thank you.

**Operator:** Next question comes from Alex Comer from JP Morgan.

**Alex Comer (JP Morgan):** Hi guys. Couple of quick questions. Just in Switzerland, I mean, ex-Linde[?] I think you said volumes were down 2%. As far as I can see, nationwide volumes in Switzerland are up around 2%. So I just wondered if there were any specific issues at any particular hospitals in this year that caused that. Was everybody down 2% across the board or were there regional differences, and therefore can we expect some bounce back this year?

To the point on CapEx, I mean, you've talked about continuing to invest to grow the business. I think since 2011 you've put something like 1.2, 1.3 billion in and your EBITDA is up 33 million, so that's been a pretty weak return. I'm just wondering, you know, have you considered cutting CapEx further? What sort of level do you think you can get to? I mean this year looks at 7%, 7.5%. Is that a sustainable level, or do you think you can go lower than that?? And I wonder, if we continue to see ongoing legislative pressure, what do you do in this business? It would seem to me it's been pretty heavily invested and therefore could maybe go for a period of relatively low CapEx.

And then just regarding the Middle East, just in terms of the impact – I wasn't quite sure the impact of the accounting change. Did you say 84 million? And therefore, does that increase the underlying margin, you know, if EBITDA isn't changed? Just some clarification there.

**Jurgens Myburgh:** Thank you and good morning, Alex. So on the Swiss questions, excluding Linde, volumes were down 2% to 3%. So I think it's 2.6% depending what metric you use for volume. There wasn't any particular hospitals. I think perhaps two or three of them didn't perform as well as we would have liked them to, to be absolutely honest. But as we highlight in the results and we also did at the half year, you know, there were some structural and systemic issues across the portfolio that we thought that resulted in revenues being down. We have recruited additional doctors to our facilities and as we indicated earlier we continue to respond to the effect of outmigration of care. And as we always do, we work hard at the insurance mix. So we do expect, in refence to my response to Kane earlier, that through the recruitment of appropriate doctors and growing our asset base and maintaining our asset base, to grow our business and grow our revenues – underlying business, so to speak.

On CapEx, I take your point on the returns. I think what we're doing is, we -as I said earlier in the response to James' question, we're responding in real time to what we see as pressure on the operating cashflow. As indicated in our guidance, we look for CapEx to be around a similar number next year. We take pride in our facilities and we have to spend money to maintain those facilities, to attract the right doctors, and through that, attract the right patients. So there's an extent to which one could responsibly reduce your CapEx. But you have to always remember that we own all our buildings except for Lakulin[?].

So in this environment you would expect CapEx to be higher because we have to maintain those facilities and keep them at the very high level that we expect it to be and that our doctors and patients expect it to be. So CapEx we expect for next year to be in line with where we were this year which was a 20% reduction on last year.

On your question on IFRS, on the Middle East impact of IFRS – firstly, the impact is that the disallowances moves out of operating expenses and goes and gets set off against your revenue to produce a net revenue number. The number that we quoted there is 84 million dirhams, which will come out of OpEx and sit against net revenue. And you're 100% right; the absolute EBITDA number wont change but the margin would probably see an uplift of about 0.3%.

**Alex Comer:** Thanks, Jurgens. Thanks very much.

**Jurgens Myburgh:** I'd like to highlight Alex, that, when you look at it year over year, what you then need to do is for this year you probably need to do a pro forma adjustment and then apply the guidance to that, if that makes sense. In terms of revenue.

**Alex Comer:** Okay, okay, okay. Thanks.

**Operator:** Next question comes from Hans Bostrom from Credit Suisse. Please go ahead.

**Hans Bostrom (Credit Suisse):** Good morning gentlemen. I had a few questions please. First on south Africa, would you be so kind to comment on what the impact or the positive impact might be on a bed basis of the CMI improvement that you talked about? Are we talking about a contribution of one or two percentage points per year if you look at this on a bed basis? Or is it less than that? I just want to get a grasp of that impact.

Secondly, could you elaborate on the thinking behind your quite convoluted investment in Intercare? I just want to understand. Maybe others know about this already. But given that they're partly an investment in part of the business and then a minority stake in the other part of the business, that would be interesting to understand.

And going back to Switzerland, could you give us a sense of the cost savings that you signal that have been – or are being undertaken. What impact would that have on a like for like basis in FY19?

And the second point in Switzerland I would like to understand is, your comment, I think it was Danie, you mentioned about doctors actually might not be interested in doing the work at a given reimbursement. I suppose the question is, what are the options? Are they just going home or are they taking their business somewhere else? Or how does this work? Thank you.

**Jurgens Myburgh:** If you don't mind, Hans, could you repeat your first question on Southern Africa? I'm not sure I understood that.

**Hans Rostrum:** You talk about an improvement in CMI and that being a driver for growth. But I just want to understand, how significant is this if you look at this on a bed basis, or whatever other unit you want to look at. But so we understand the impact of this going forward.

**Danie Meintjes:** Thanks Hans. Danie here. I think the reference to the case mix index was to give you a sense that our tariff went up while the [inaudible] was actually slightly lower. So what we indicated is that the quality of revenue is increasing due to the CMI. And in terms

of the investment it is more into the high care areas where there is neonatal or adult ICUs and high care units, that demand is going up and that was the whole point. To give it to you per unit, you can try to do it, but I don't have those numbers in front of me.

**Jurgens Myburgh:** It just gives us a [inaudible] on inflation. So generally when we look at the revenue growth of the business Hans we would say, what do we expect from volumes. And I think there we are guiding is at 1% to 2%. And there for an inflationary increase. And it's possible we get a slight uptick on inflation because of the case mix index, but it's not something that we break out because it's not that material particularly in the garden.

**Danie Meintjes:** In terms of Intercare, Hans, just to remind you, Intercare is a standalone, separate entity, run by a clinician. They are into the primary care environment where they focus on disease management, but they also have in addition to their business, let's say, the normal outpatient activity where they have post hospital care and also day care facilities. So the business must be split in two. We took over a majority of let's say the hospital related businesses, the day hospitals, and a minority share in the outpatient facilities, the primary care division. And the logic for that is we are quite convinced that the shift in terms of keeping people healthy; making sure that you will have a combined offering in terms of network when you contract with insurance people. Not only a hospital, but also the pre-hospital services. To have that aligned in terms of quality, cost management, etc. And in future maybe post-hospital will become more and more relevant, and for that reason we know the people well, they've been out around for a long time. To align with them it gives us a safe entry into that to understand the business better because long term we believe it'll be more and more important. Does that answer your question on Intercare?

**Hans Rostrum:** Yes. And maybe there is an interest of the owner to retain the control of the primary care business. Why wouldn't you want that in a similar way as you do the post-acute and the day hospital business?

**Danie Meintjes:** There's a technical reason. For the day hospital business, if we transfer our pricing, etc., then there's a Competition Commission control issue. So it makes it just easier if you have a majority there. On the three hospital services, that is the area that we need to guide in the expertise. We don't have it. So we want to have a slow entry into it, it is doctor-owned, doctor controlled. It is a big component of that income is in a consultancy basis. As you know, in South Africa, corporates are not allowed to send bowls[?] on behalf of doctors; that must be owned by the doctors' component and that is for those technical reasons. We want to understand that part of the business better. And our value add [inaudible] is limited in the outpatient environment.

**Hans Rostrum:** I mean I suppose it's early days. But do you foresee that there might be some form of change in regulation regarding the doctor – well, the regulation on not controlling the doctors, and so forth and wonder why you don't...

**Danie Meintjes:** Very difficult to predict. Maybe the health market enquiry that will come out the first report next week might give us a sense to it. My personal view is the short answer is yes. When, I don't know. But the regulation where corporates cannot employ doctors to have a better integrated system has been proved to be efficient all over the world. I think it's out of line in South Africa, it should come better in line.

**Hans Rostrum:** Great. And on Switzerland?

**Danie Meintjes:** Switzerland, in terms of cost savings, over to Jurgens.

**Jurgens Myburgh:** We don't break out exactly the number. We give you guidance on what we think next year's going to look like. And that guidance includes the impact of [inaudible], the impact of outmigration. And then offset against that, the annualised benefit of the cost savings that we had in this year. The kind of things that we've been doing this year is around hiring freezes and cost saving initiatives on admin and overhead. You know, we've had an FTE hiring freeze and standstill. And as I said, actually, part of the movement was that we came off a very good prior year and obviously budgeted in accordance with that. So it was addressing really where we had budgeted to and where the business was at the back end April 2017 and adjusting that, which we've done.

We had a supply cost headwind in as much as specialised treatment and [inaudible] insured patients increased our supply cost on a relative basis, which then offset some of those savings. But we anticipate the annualised benefit of those savings to somewhat offset what's going on with outmigration and [inaudible] to get to the guidance we've given.

**Danie Meintjes:** In terms of your next question, the reference to the doctor at the lower price point, just to give you an example. If a doctor is close to retirement, if he's established himself, he's made his money. If he was used to a tariff or a hernia, for instance, of let's call it 100, and now all of a sudden that 100 is down to, whatever, whether it's 40 or 50 or whatever, that doctor might be in a position to say, you know what, I'm not going to do the small stuff at this ridiculously low price compared to the previous price; I'd rather take off, I'd rather spend time on anything else, or try to get more of the complex work.

What is the result of that? Some of those work can glow to the younger doctors establishing themselves. Evidently some of the work will flow over to the cantonal hospital where the doctors are on a big salary and whether they do a small case or a big case, that doesn't influence their income directly. My interpretation is, if that swings over to put the cantonal systems under further pressure in terms of activity and the cost to treat the patient. I believe that price point will naturalise, mature – will get to an equilibrium in years to come because the indications are that it is very – too low actually for cantonal or the private sector. So over time we'll see how that sort of pans out.

**Hans Rostrum:** Thank you.

**Danie Meintjes:** We've run over time already and we've got some further calls. Can we take one last call and then I'll hand back to James.

**Operator:** Last question comes from Shawn Ungor[?] from Acorn Capital[?]. thank you.

**Shawn Ungor (Acorn Capital):** Good morning, guys. Thanks for your time. Just a quick couple of questions. In terms of gearing at the moment, if you could maybe just comment on your sort of what levels you're comfortable with obviously in terms of expansion plans for the M&A and sort of outlook [inaudible] EBITDA.

And then just also in the results you come in to around the long-term options [inaudible] Middle East on there, businesses ongoing with more colour in Q3 later this year. Could you give a bit more colour on that please?

**Jurgens Myburgh:** Just give a little bit more colour on the last question? On the Middle East?

**Shawn Ungor:** Sorry, are you asking me to repeat?

**Danie Meintjes:** Didn't get that actually.

**Shawn Ungor:** Are you asking me to repeat? I can't hear you guys.

**Jurgens Myburgh:** Please repeat your second question if you could.

**Shawn Ungor:** Okay, cool. Great. So in your results you've got a commentary around review of long term options to enhance the Mediclinic Al Noor business that is ongoing, with more clarity to be provided in calendar Q3 this year.

**Danie Meintjes:** Okay, I think I've got that. I start with that, and Jurgens can come back to the gearing levels. The Al Noor hospital is the old Khalifa[?] Street, the multilevel hospital where we have a problem in terms of access to the higher floors for inpatients. It is a lift configuration. They found a solution.

Second problem is the access to their hospital that is facing two streets: a proper front street and a back street. The entrance is only from the back street. Very clumsy design. The flow is not good, and we want to bring the high activity of outpatients lower to put less stress on the lift system there. So that ground floor, mezzanine floor, having an emergency unit or a walk-in unit, and some of the outpatient activity, reconfigured. Redo it and give it a much better flow and look. That is what we refer to.

**Shawn Ungor:** Okay, so it's all just purely related to Khalifa. It's not a whole owner deal[?]?

**Danie Meintjes:** The Riyadh[?] hospital is now called the Mediclinic Al Noor hospital.

**Shawn Ungor:** Okay, got you. Okay, cool.

**Jurgens Myburgh:** Thank you. So on gearing as I alluded to during the presentation, we used the concept of responsible leverage which applied to the cost of that leverage as well as the refinance for that leverage. And we'll go into more detail one on one. But we're comfortable with the levels of gearing with the after moment[?]. as I said, we manage it per platform with no cross guarantees or cross defaults. We actually need a process – we refinanced as I indicated the Swiss gearing in the middle of the year and have seen some really good benefits coming out of that. And so comfortable where we are and if you look at the next two years especially in Southern Africa, going through the back end of the upgrade cycle and the expansions in the Middle East, which is our growth platform, you would see the use of those borrowings continuing for the next two years. But they potentially after that somebody will always deleverage in those regions. But comfortable with leverage where it was at the moment.

**Danie Meintjes:** Thank you. I think that concludes the Q&A. Over to – James

**James Arnold:** Sorry, I know that we've not completed all of the questions that had been submitted so I'll take those offline and we will come back to you. So thank you once again for all your time and we look forward to seeing you in the coming few days.

**Operator:** Thank you. That concludes today's conference. Thank you for your participation ladies and gentlemen; you may now disconnect.

[END OF TRANSCRIPT]