Conference call transcript

12 May 2017

INTERIM RESULTS PRESENTATION

Operator
Good day ladies and gentlemen and welcome to the Life Healthcare group interim results presentation. All participants will be in listen-only mode and there will be an opportunity for you to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing star then zero. Please note that this call is being recorded. I would like to hand the conference over to Adam Pyle, the Investor Relations Executive at Life Healthcare. Please go ahead, sir.

Adam Pyle
Thank you very much. Good morning everyone and welcome to the 2017 Life Healthcare interim results presentation. Just for those of you in the room just to remind you our mics are live so if you can please be quiet. And also keep your phones on quiet. Thank you very much. I'm going to hand over to Andre Meyers, the CEO of the Life Healthcare group. He will do an operational review of the southern African business, the business in Poland, Scanmed, as well as our business in India, Max Healthcare, our investment in India. He will then hand over to the CEO of Alliance Medical Group, Guy Blomfield, who is on the line from the UK. Good morning, Guy.

Guy Blomfield
Good morning everybody.

Adam Pyle
So once Guy has finished with the operational review of Alliance Medical Group he will hand over to Pieter van der Westhuizen, the CFO, who will cover the financial review, and from there we will hand back to Andre for a brief outlook. Once Andre is done we will then take questions. We will start with questions in the room and we will then take questions on the call and via the webcast. On that note I will now hand across to Andre.

Andre Meyer
Thank you, Adam, and morning ladies and gentlemen. As Life Healthcare our vision is to be a market leader and international diversified healthcare provider. This vision is supported by our diversification strategy driven by the desire to enter higher growth markets, expand within South Africa into complementary services, to expand internationally into the higher growth diagnostics market, and to expand into the fast-growing Indian healthcare market. Our latest acquisition, Alliance Medical Group, was completed in November 2016. This transaction is transformational for Life Healthcare in that it further supports our diversification across the full continuum of healthcare delivery and across different territories. We are now in the process of bedding down and aligning and integrating opportunities between the different territories.

On our strategic acquisition objectives there is a clear match between Life HealthCare's objectives and what Alliance offers us, which supports our strategy across the board from entering a higher growth market, expanding our complementary services, to geographical diversification, a market-leading provider of diagnostics services, and importantly an experienced and a committed management team. The benefits of the combined businesses, Life Healthcare and Alliance, the combination of these two businesses are clear in that this transaction has given us exposure to the higher growth diagnostics market and a company which generates

good cash, good margins and excellent growth prospects. Alliance also complements our strategy to expand our complementary services and our integrated model of delivery and care.

On the financial overview we've delivered good revenue and EBITDA growth with revenue up 22.6% and EBITDA up 15.2%. Our normalised earnings per share were impacted by costs incurred in the Alliance transaction. The slide also reflects the impact of this transaction in terms of both the geographic diversification achieved as well as the growth of our complementary services. On the operational review as Adam mentioned I will take you through the operational review and Guy Blomfield will talk about the operational review in respect of Alliance Medical Group.

Starting off with South Africa the SA business has come under pressure in H1 with a drop in activities. This has impacted occupancies and pressures on cost have resulted in a decline in margin. PPD for the half year declined by 1%. This is an improvement on the activity numbers that we presented as of February, but we did have the benefit of Easter being in H2 in the current year compared to being in H1 in 2016. Despite the pressures we have seen strong growth in our complementary services with the additional of 60 mental health beds in February and 35 beds in the beginning of H1 as well as the impact of the second oncology unit. Compound annual growth rate over the last five years for the SA business has been 8.1% and within this is a compound annual growth rate of 18% for the complementary services which has benefited from strong underlying demand. The healthcare services business is under pressure for reasons we have communicated previously.

Our expansion in the current market is being done very carefully and hence the expansion in mental health beds, renal dialysis as well as select brownfields bed. This will continue to be our approach in the foreseeable future. I have spoken about the pressures of occupancy with overall occupancy declining by just under 1%. Complementary service occupancy was resilient despite the slight decline as we improved mental health beds by 24% in H1. Medical cases continue to increase on the growth in mental health and also due to [break in audio]. And as a result we have seen an improvement across our patient experience score. On the clinical side there continues to be an absolute focus on compliance to our clinical protocols and our hospital reporting. In addition we have also introduced new clinical indicators within our existing clinical protocols and we have started a process of alignment of reporting to international benchmarks.

On healthcare services on Esidimeni I would like to start by expressing my sorrow and my deepest sympathy to the patient who died in the transfer from the Life Esidimeni facilities last year. We are pleased that the health ombudsman absolved Life Esidimeni from blame in the process. Life Esidimeni was impacted by the non-renewal of 1,570 mental health beds as of July 2016 by the Gauteng Department of Health. However I am pleased that we can award part of the tender and we will see the return of approximately 700 Gauteng mental health patients during the course of H2.

On the Competition Commission healthcare market enquiry the HMI is entering a crucial stage in its lifecycle and there is continued and extensive engagement from Life Healthcare in this process. In terms of new timelines that were published in December last year the proposal is for the report to be completed this year. There is however a huge amount of important work that still needs to be done before the completion and the release of the draft report.

On Poland the Scanmed business has suffered the decline of cardiology tariffs. We received the first decrease of tariffs of 17% in July last year and a further tax of 11% that was effective 1 January 2017. Our response has been to immediately institute a series of cut cutting and efficiency measures and we have made some good progress in that regard. The margin has been impacted by an impairment of over quota work.

India remains a good growth market for healthcare on the back of strong economic growth, a growing middle class, an aging population and increasing disease burden. Max Healthcare has shown good revenue growth on the back of very good growth in phase two and three hospitals. And this is despite the impact of demonetisation in November and December which carried through into January. We are seeing good revenue growth in the phase two and three hospitals as I said of 26% and a strong improvement in EBITDA margin from 10.6% to 11.7%. We have also seen an improvement year on year despite a 69% increase in beds over the five year period. I'm now going to hand over to Guy Blomfield who will take you through the Alliance Medical business review.

Guy Blomfield

Good morning everybody. We thought it was useful given that Alliance Medical has now been in the Life group for less than six months to remind everybody of the composition of the business. And there are differences across the geographies what the strategy is and the business performance over the last six months. But by way of reminder the first few slides capture that. So on slide 18 in the UK the composition increasingly is a mix of nuclear medicine captured by PET-CT where we have a national contract basically covering the provinces representing a shade over 60% of UK provision of PET-CT which is clearly a very important diagnostic. It's the highest end diagnostic service that we provide. And usually in this market we do so in an integrated way. You will see there at the bottom of the UK schematic and columns the radiopharmacy reference. And we operate an integrated model where we produce and manufacture the radiopharmaceuticals that are injected into the patients at the delivery of that scan.

This integrated model has differentiated Alliance Medical significantly and when combined with our partnership with The Christie, the largest cancer centre in Europe based in Manchester, that jointly govern and support, the delivery of this service, we have a public private partnership model which I think can be emulated in other markets going forward. And importantly this capability in nuclear medicine is one that can progressively support the broader group within Life. The other half is predominantly MRI which is a mix between statics which are facilities in hospital and mobiles which are essentially scanners on lorries that support interim services.

In Italy we have a combination of clinics and static contracts, but by way of emphasis the clinics dwarf the revenue of those of the statics. And on a like for like basis we have been proactively running of static contracts that were sub-economic. So when I get to the end of this section one of the reasons for relatively low levels of revenue growth is because of the proactive wind-down of these contracts, the underlying revenue growth being stronger. And then in Ireland we have a mix and a mixed economy and we operate across both the north and the south. Those jurisdictions represent about 90%. We are now progressively moving into other geographies, particularly into the Nordics, progressively in Germany, and over time given the opportunity of Scanmed and their expertise and market knowledge we will work with them closely to develop imaging services as appropriate in those markets, nuclear medicine being a real opportunity.

So over the page a little bit more on composition. You get a mix in terms of the emphasis and a few points of note. In terms of community clinics I referenced a moment ago in Italy that we operate clinics. And you can see the scale of those relative to the other service lines. These are large outpatient centres where the norm is to provide outpatient diagnostics over 50% of which are outside of a hospital in these independent clinics. And we have the largest portfolio in Italy. Our strategy is to proactively grow and add a clinic portfolio where we operate in a partnership way increasingly with local commissioners to support their future capacity requirements. In the UK you can see the mix, and we are taking proactively the Italian community model into the UK. That is nascent at the moment but it is hugely encouraging the response that we are having to the development in an integrated way with hospitals to extend their imaging departments into the community as their outpatient

facilities can no longer cope with the demands placed upon them. Again the model of care being one of partnership and integration with the recipient hospitals.

On page 20 given the importance of nuclear medicine in my introduction just a few metrics here that remind us of the UK as behind the curve in terms of its provision of scans for the population, the top left 1,300 scans versus the average in Europe of 2,900. We are progressively charged with not meeting the European average but driving through it to create this world-class capability. And the economic benefit is simple if you have good diagnostics and the downstream phasing is evidenced. NHS England is very supportive of this drive to close the gap. The bottom right hand there captured the sobering statistics of cancer survivorship in the UK is equally behind that of its European peers. And the view is that nuclear medicine and better staging and earlier diagnosis will support that closure of the gap.

On slide 21 we pride ourselves on the ability to deliver a full end to end service. This is documented six months ago for a number of you. But this is hugely important that we have the ability in each of these nine stages to provide significant quality and demonstrate that, but do so in a cost effective way. And the business model essentially is one of highly efficient services that allow us to share through that efficiency a lower average price point for our customer set, yet quite rightly still evidence quality and achieve a margin as a result. But we have proactively as I said moved into the higher end modalities which again accretes to that margin gain.

So in summary on page 22 in Western Europe we are the market leader. Our peer would be Affidea [?] but predominantly they represent the east of Europe. This relentless focus on collaboration and quality fits with what Andre has said and firmly fits with Life. The national footprint will over coming years – and we are embarking on this at pace – add to our European footprint and take our nuclear medicine model into it. To that end we have recently acquired more cyclotrons in Germany. We closed that in the last two weeks, an acquisition from Eckert & Ziegler where they had sold us their cyclotron business, which allows us to evidence the ability to have the integrated model into Germany, parts of Austria and parts of Poland as discussed, this integrated approach being the differentiator primarily and the ability to start a service with mobiles that are peripatetic and then progressively have a static footprint. To the top left of slide 22 I've referenced the growth in the UK will not just come from PET-CT going forward. We are very encouraged by bringing the Italian community model to the market.

In slide 23 it explains in part why you can see the margin growth and the EBITDA growth outweighing that of revenue. But we have proactively turned off some of these sub-economic contracts in Italy. The bottom bullet point also highlights a policy that we put in place which we believe has now come through. We can see the like for likes coming through again where they put an appropriate degree on certain modalities including MRI which essentially pushed referring clinicians to a higher hurdle to have an appropriate referral. Many of those degrees have now been thrown out. They weren't viewed as appropriate for want of a better use of that word, and now we are seeing those like for likes coming back. So we continue to be encouraged. The PET-CT volumes are coming through as per plan. A little bit of a challenge we have in the UK as we transition to static facilities is we open for five days and some of the facilities don't have the level of volume that accretes the margin. The volume growth for PET-CT is around 15% and I'm sure you can ably capture as that growth comes through the marginal cost of delivering the next scan doesn't incur additional fixed cost and therefore accretes margin. And we are seeing that coming through strongly in these sites. Thank you very much and I will hand over to Pieter.

Pieter Van der Westhuizen

Thank you Guy. From a highlight perspective trading has benefitted from the inclusion of Alliance Medical Group from 21st November so revenue is up 22.6% and normalised EBITDA is up 15.2%. Normalised EPS is impacted by the acquisition transaction cost as well as the funding cost relating to the [unclear] and is down 35.7%. The total

acquisition enterprise value is R14.3 billion. That includes a full consideration of £40 million. We expect only to pay around £21 million of the £40 million so there will be a [unclear] coming back to South Africa. And then we had an interim distribution in the form of a script of 35 cents. And I will talk a bit later about our thought process behind that.

From a revenue perspective the SA business is up 4.7% against last year. That is really made up of two components. One, the pricing from South Africa at around 6.3%, 1% down against PPDs, which gives us about 5.3% at a price level. And then the second impact is the Gauteng contract on Esidimeni that takes us down to about 4.7% for SA. Alliance is just included for roughly four and a half months. And then Poland, two factors. One is what Andre alluded to, the impact of the tariff reductions in the country, and then the second impact we saw the strengthening of the Rand by around 10% on the Zloty compared to last year so that has also impacted the turnover and EBITDA level.

EBITDA. The southern African operations are roughly 2% down. If one strips out the impact of the Esidimeni contract that is roughly about 1% down only. The Esidimeni contract given the nature of the contract is high operational leverage benefit and so it does give us quite an uplift if you take it out from last year. It is only 1% down in SA. Poland down largely due to the impact of the contract that we lost. The inclusion of Alliance has increased our EBIT before amortisation to R1.9 billion, up 8.2%. The amortisation attributable to the Alliance transaction is significant in terms of the intangible amortisation going forward that will hit the income statement. This is a non-cash-flow item so when we look at our dividend we add it back from that perspective.

Earnings as I've said earlier are down 85% mainly impacted by the acquisition and transaction cost of R309 million and then funding costs for all acquisitions to date included in the current period is R500 million. Of the R500 million about R270 million will not recur from the second half due to the rights offer being concluded towards the end of April. On a segmental basis the southern African operations hospital division has seen EBITDA margins drop 24.8% to 23% largely due to the loss on operational leverage from the PPDs being down around 1% and the drop in occupancies. Healthcare services saw a similar drop of 2% from 16.8% to 14.8% due to the impact of the Gauteng contract being lost.

Just a high level transaction overview of Alliance. Our initial cash consideration was £553 million. We acquired 94% of the business. Management bought the remaining 6% and that contributed £33 million. We assumed debt of £167 million and then our estimated deferred consideration will be £21 million. So that's the total enterprise value. The purchase consideration was initially funded through debt being raised in the UK and then subsequent to that we paid a large portion of the South African debt through the rights issue which was concluded towards the end of April. Just to note that the management equity component of £33 million for accounting purposes will be fair valued through the income statement as part of [unclear], not as you would normally see it as part of minority interests. So strange accounting standards, but that's unfortunately how it works. It's a non-cash-flow item again, so we will be taking that into consideration when we determine our distributions. Earnings per share reconciliation, 85% down from 93 cents to 13.7 cents this period. If one strips out the impairment of the current investments and the property disposals we're down 71% at the headline earnings per share. And then the other transaction costs related to the Alliance transaction we're down 35% to 56 cents at the normalised earnings level.

On slide 33 South Africa is relatively flat at 0.6% against last year. Both Poland and India are down a total of 2.9% compared to 1.3% profit in the last year, mainly the impact of the Polish operations. The Indian operations had a R9 million loss for the six months. As Andre said at trading level the Indian operations did really well. They increased their EBITDA by 20%. But they were impacted by the interest costs related to the two transactions in the previous financial year, the Vaishali facility and Saket facility. And then the funding cost impacting down to

48 cents. If one assumes that the rights offer was done on 21st November at the date of the transaction and we add back the interest, the R260 million the normalised earnings per share would be around 79 cents compared to the 87 cents, a 9% dilution. Balance sheet, the biggest impact is the Alliance transaction as far as the consequential funding that we've raised for the transaction. Our net debt to EBITDA going up to 3.99 times. That has reduced subsequent to around 2.35 times after the rights offer has been concluded. Our weighted average cost of debt is relatively at similar levels, 6.5%. But that is impacted by the acquisition because the acquisition is not tax deductible. Because we will repay that we would see that our average interest rates will reduce going forward.

On slide 36 is a breakdown of our 2.35 times. Our bank covenant is between 2.75 and 3 times. We are in the process of negotiating with the bank to extend that up to 3.5 times. And we will utilise our balance sheet to its extent but we will try and conserve it in terms of the gearing levels to take into consideration the uncertainty of the economy in South Africa specifically where still we've got a large debt [unclear]. Then on the distribution it was quite a difficult process to go through from a distribution perspective if we look at income statement and the cash flows. Related to the acquisition we had quite a number of once-off items. Therefore the board considered as part of their thought process the impact of the rights offer that we just concluded towards the end of April, the once-off acquisition costs, as well as the higher debt levels that we see at present and potentially going forward. In addition to that we see what growth opportunities are in Alliance and in South Africa and based on that the board decided to declare an interim distribution of 35 cents with a scrip cash alternative. We see that we will continue paying dividends from a group perspective. We will review our position at the end of the financial year in terms of giving more clear guidance of the pay-out ratio going forward while we bed down the transaction of Alliance and making sure from a [unclear] perspective how we define [inaudible segment]. I hand you now over to Andre.

Andre Meyer
Thank you Pieter. The outlook for H2 following up with southern Africa as I said in the previous part of the presentation our careful expansion will continue with a focus on brownfields and expanding our complementary services. We do expect continued pressure on PPDs to remain for the balance of the year. We also continue to drive efficiencies and focus on cost cutting with the drop in activities, and we will explore revenue opportunities through product development. On international starting off with Alliance we expect continued good growth in the UK on the back of the underlying demand. The PET-CT contract with NHS England will continue to be rolled out with an increase in volumes. And as a result we are investing in increasing our radiopharmacy capacity in the UK to make sure that we are able to meet the future demand. The CDC programme will start this year and this will allow a greater partnership with the NHS and also the ability to grow volumes as we deal with the overflow through those units. Guy spoke about the transaction in northern Europe, the Eckert & Ziegler transaction. And that positions us very well in the northern Europe territory to expand into PET-CT services.

On Poland we will be positioning the business to benefit from the new contracts and tenders. That is underway at the moment and we expect that there will be an announcement in that respect sometime towards the end of July or sometime in August. We will continue to focus on increasing the percentage of non-government business and we will continue to focus on driving efficiencies and managing costs. In India the IP have announced their disposal of their stake in Max Healthcare and Life Healthcare and Max India will acquire this in equal share. This will allow us to retain our equal shareholding, protect our shareholding rights and continue our partnership with Max in a fast-growing, exciting market. Thank you very much ladies and gentlemen.

Adam Pyle

Thank you. The process in terms of questions is we will start with questions in the room, and then we can over to questions on the line and finally questions that come through email on the webcast. Can we open for questions if there are any in the room?

Male speaker
Adam, maybe I can start. Morning. What are your expectations for patient days in the second half? Because it seems the healthcare funders, this initiative that they've had to curtail hospital admissions and greater focus on costs from their side, only seemed to really kick off with like Discovery in August/September last year. And they started deploying into hospitals to make sure it is not over-servicing. So it would appear that kind of initiative is led by Discovery. Number two it is only something that has occurred over the last six months. And I do believe that it is something that could gain momentum if others follow suit. I'm just wondering what your thoughts are for the second half in context of this greater oversight.

Adam Pyle [?]
Look, I think we have taken a very cautious outlook. We do see continued pressure on our PPDs in the second half of the year. Our view is that we would expect the year to have probably a negative PPD growth, down on last year. We do see pressures on medical aids in terms of admissions. Also this is a very competitive market. I think it is a function of the fact that there has been no life growth now for three years and you've had beds and capacity added. So I think we've got a very competitive market and pressures from funders in terms of trying to manage the utilisation. There is the balancing fact that from our side we continue to expand the complementary services to get the benefit of the mental health beds. We still see good growth in this. So there is still the underlying belief in [unclear] but it is going to be unchartered waters. We are taking quite a cautious view. And as part of that we see constrained growth so there is a process in place in terms of managing costs in that environment.

Male speaker
What do you think the [unclear] of this initiative by Discovery [unclear] other medical aids following suit and having similar strategies?

Adam Pyle
I think there was a process in Discovery where they were analysing the increase in utilisation and they were able to allocate certain categorises of utilisation increase to [unclear], to aging, to [unclear] etc. within Discovery. And there was a component which they called supply side utilisation. And their view was there some processes which where happening which they didn't think were appropriate or were outside the protocol of how you should book patients. You've had the case managers in the hospitals for quite a few years. So it has expanded that. I think it is more to do with the admissions and whether those admissions are appropriate. It is outside our range of focus and we don't get involved in that. I'm sure the other funders are saying can we do the same thing. We've seen some of that from GEMS. There has been a process from GEMS over a similar time period because GEMS has had pressure in terms of their levels that they've seen. We see a little bit from the other funders. We haven't seen too much.

Andre Meyer
I think what we have seen since September last year was GEMS and Discovery at the same time. What we have seen is that we've seen continued activity in [unclear]. And Adam mentioned preadmissions making sure the patients are admitted for the appropriate reason, addressing the issue of non-appropriate admissions, and then also the process in hospitals of active case management. So as I said in my part of the presentation we certainly see that continuing. The Discovery and GEMS certainly have the resources to deploy those types of people. I do think that the other medical schemes will certainly consider doing something similar. To what extent is [unclear]

at this stage. I think [inaudible segment] and we have seen you get a reaction from doctors in terms of decreased admissions. But we see some of that starting to come back. So it is [unclear] this point actually to see how it's going to play out. But we have taken a cautious approach in saying we don't see too much in terms of our [unclear].

Adam Pyle
Just to add on the issue of caution we are very cautious about the beds that we are adding and the capex that we are spending. The focus is primarily on the complementary where we do see strong demand.

Male speaker
Adam was saying there are no new members added in the last three years by schemes but you are seeing continued growth in bed numbers. So do you get the sense that the market is oversupplied?

Andre Meyer
It is an interesting question whether it is in oversupply. I think there is certainly pressure on occupancies. If you look at these graphs you can see the pressure on occupancies. So it has always been our view that we have a market which doesn't grow in line. If everyone keeps adding beds you do get to a point whereby there becomes pressure on occupancies which would lead potentially to pressure on pricing. And we have seen that in this country. So we have a strategy whereby we focus on driving our clinical care and focus on driving [unclear]. We are very careful in terms of how we are looking at growing in the business in terms of select areas. So we do have hospitals which have incredibly high occupancy and there is capacity to expand in those hospitals. But we remain quite cautious in terms of how and where we add. The point that I mentioned in my outlook in terms of [unclear] that we are working in close collaboration with our doctors to ensure that we can put products together that will add value to the funders by reducing the cost of care that is delivered but at the same time also ensuring we do not [unclear]. That's a key focus for us in the South Africa business to put these products in place.

Male speaker
A question on Alliance Medical. Here you say that the rationale for the acquisition was the prospects that are looking good. What I want to understand is where actually this growth is going to come from. I want to understand the market that this company operates in in Europe. [Inaudible segment].

Andre Meyer
So the growth is really going to come from the UK market. As Guy explained in his part of the presentation the survival rate for cancer is the worst in the UK or England as compared to the rest of Europe. And the NHS PET-CT contract is specifically aimed at improving those outcomes. There is strong demand worldwide from growing incidence of cancer, and diagnostics play a very important role in that. And then also if you look at the continuum of healthcare delivery what is happening, this worldwide trend, is that there is an increasing focus from funders both in private sector and in the public sector to drive early diagnosis of a condition. Because what you do through early diagnosis is you have a better chance of recovery and you are able to better manage the downstream costs. Guy, are you still on the line?

Guy Blomfield
Yes.

Andre Meyer
Do you maybe want to…?

Guy Blomfield
I think you ably answered the question. I think you captured it very well.

Male speaker
I just want to check and follow on that question in terms of a potential update per geography for Alliance. The UK sounds like everything is on track as per prior guidance. Italy is a bit softer as far as guidance. So any updates on Alliance in the rest of Europe?

Andre Meyer
Guy, do you want to give a brief overview of some of the activities to do with the plans in northern Europe, how we're thinking about expanding into Europe?

Guy Blomfield
The nuclear medicine area the prominence I believe Alliance now has as the NHS partner for the provision of PET-CT is an area that we can build on into other markets. You need to be quite targeted here because clearly not every country by definition has the same challenge that the UK did and that we're trying to address. Having said that Germany for example where there is an under provision and to date they have used substitute modalities, CT scans, gamma camera scans, not PET-CT. our view which I think is grounded is over the next five years that will change and we want to be in a good position to support the delivery of PET-CT as it grows in that market. Equally Norway is another good example. I acknowledge a small population. But we now have a partnership model in Norway and we are delivering PET-CT scans into the greater Oslo hospitals, the rural hospitals outside of the city. And where we're encouraged with that service that's going really well, and now progressively in Finland and if we can crack Sweden as well. So there is quite a bit of a push.

As ever when you talk about countries it sounds grand. These are smaller countries, but they will materially contribute marginally to the economics of the business. The other side of PET-CT currently circa 95% of the activity is for oncology. But the growth is coming from neurology. And whilst there aren't recognised therapies for diseases such as Alzheimer's we are experiencing from research and practitioners the desire to better diagnose with the support of PET-CT and the application of the neural isotopes as opposed to the oncological isotopes to support that. Given our prominence in the UK we are proactively supporting research for this. Our capability therefore to take that expertise for oncology and progressively neurology is a very important differentiator again. And we believe that a number of northern European markets can benefit from that, hence the success in acquiring the Eckert & Ziegler cyclotrons allows us to integrate that service. I also think importantly what we can do to use that expertise to work in partnership with clinicians and the hospitals in South Africa is something that will be worked on over coming months. There is clearly a very strong support from established clinicians. And if we can work with them to develop these services and bring our expertise to support the differentiation of Life in these very important categories that it something we are quite excited about.

Male speaker
Thank you. I just want to ask another question. If I look at the numbers from a month ago [unclear] Alliance you showed historical information. I know you have expanded the footprint to a more static model. Obviously the depreciation charges have all increased on the back of that. So I'm just trying to get some sense of guidance in terms of where EBIT margins will settle. Will they expect to go higher from where these reported numbers are or will it take a couple of years to ratchet up? What are you expectations around where we stand now versus historically?

Guy Blomfield

We operate quite a prudent depreciation policy which I think is the right thing to do. You are quite right in your observation. By definition as you start investing in facilities your depreciation line adds a fixed cost. The important point though is these facilities have quite high degrees of operating leverage. So as you add the growth in scanning the marginal economic cost of doing so is negligible and therefore it accretes to your net operating margin. But I think your observations important. It's a function of both how much you invest and the level of growth that follows. And I would say given our investment profile your point about a one to two year timeframe before you really see the acceleration in that net EBIT margin would be fair. A one to two year horizon. Pieter, would you agree with that?

Pieter Van der Westhuizen
I agree. I think from an EBITDA margin perspective as we put the static down there is a bit of a margin dilution because you've got more fixed cost as you ramp up. So as we roll out the statics you will see a bit of a potential EBITDA margin dilution as well as EBIT margin dilution. The moment you start getting your operational leverage coming through then you see the kicker. So we would see as the CDCs and the PET-CT is being rolled out that the margin would increase.

Male speaker
So going back to the previously disclosed margins it sounds like it might be a bit longer to actually get from where we are now, maybe even beyond two years. It sounds like it's that sort of timeframe to get back to... This is what I'm trying to gauge. Is it possible to get back to where the margins were before or will it be below that, improved but below where it was? That's the feeling I'm trying to gauge or obtain.

Andre Meyer
We can improve on those margins just depending on how quickly we can load up the PET-CTs. [Inaudible segment] on the numbers coming through and the utilisation.

Adam Pyle
Any other questions?

Male speaker
Can I ask a similar question on margins? Can you give us some guidance on Poland? You had margin reduction. Can you give us some guidance on where you see margins going to?

Pieter Van der Westhuizen
From a Polish perspective there is an impairment charge on over quota work. That is a once-off item. There is over-accruing effectively for revenue for a number of years in that business. The total impact of that was about R23 million. If one strips that out then the margin goes to about 9.3%.

Male speaker
Is that where you see margins stabilising from 13.5%? Okay.

Male speaker
[Inaudible segment] pay down debt or for alternative acquisitions?

Andre Meyer
I guess it would be to a couple of things. Our preference would be to expand for growth. But you very rarely get the timing right on these things to do it, so we would probably pay down our debt, reduce our debt costs. But we certainly look to use that cash to invest in growth. If there are no more questions we can see if there are any

questions from the call. The question that has come in on the webcast appears to be [unclear]. So if there is nothing else [unclear] the webcast.

Male speaker
In SA the [inaudible segment]. Do you see a change to your margin guidance there from an SA perspective?

Andre Meyer
I think in this environment margins are under pressure. Our guidance would be that we've got certain programmes in place to manage our costs better. You take a knock in your occupancies [inaudible segment]. So a lot of it is about how well you execute on those programmes. Our guidance [unclear] we would look to get an improvement in the second half [inaudible segment]. But I suppose [inaudible segment] but we would typically see in the second half slight margin [unclear] mainly because of [inaudible segment] we would rather guide that margins will be maintained. [Inaudible segment]. Any more questions?

Male speaker
Can I just ask, of your revenue at Alliance, the last six months which you show us, how much of that is roughly CT scans? I just want to get a feel for the mix roughly.

Andre Meyer
Guy has to back me up here. Half of the revenue is UK. About half of that give or take is CT. Is that correct, Guy? He might have gone off.

Pieter Van der Westhuizen
That is right.

Andre Meyer
I think [unclear] say thank you to you all for the conference.

Male speaker
I just want to ask a last question from me. Poland, I've heard – I don't know how true it is – that there is attrition of doctors there. So firstly is that true, and secondly, how will that then going forward impact your ability to achieve those 9% margins?

Pieter Van der Westhuizen
We have not had any problem recruiting doctors. In fact we have had over the last six months quite a drive in recruiting doctors really for two reasons. First of all that we wanted to improve the quality of the care that we deliver. And secondly because we want to increasingly focus our revenue on non-government work, which we have done quite successfully, grown non-government work year on year by 10%. So I think as in any territory it is a competitive environment to attract good doctors but we are doing [unclear].

Andre Meyer
I think the one [unclear] on that is within the cardiology business we have cut our salaries in cardiology. So it's the whole market. [Inaudible segment]. And it is a potential risk [inaudible segment]. It's not a question of us substantially underpaying versus competitors.

Pieter Van der Westhuizen

Adding to that, we were hoping to cut those salaries by 18% and because of the competitive environment around good quality cardiologists we managed to cut their salaries by 10%. Otherwise we would have lost doctors.

Andre Meyer
[Inaudible segment] in this environment an opportunity because of the fact that we [inaudible segment] and we're in a much more secure position. [Inaudible segment] under a lot more pressure. There is a potential in terms of gaining more doctors. Okay. Thank you very much.

Pieter Van der Westhuizen
Thanks.

END OF TRANSCRIPT