Conference call transcript

6 October 2023

PROPOSED SALE OF ALLIANCE MEDICAL GROUP

Operator
Good morning, ladies and gentlemen, and welcome to Life Healthcare's proposed sale of Alliance Medical Group investor presentation. All participants will be in listen only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call, please signal an operator by pressing * then 0. Please note that this call is being recorded. I would now like to turn the conference over to Peter Wharton-Hood. Please go ahead, sir.

Peter Wharton-Hood [Group Chief Executive of Life Healthcare]
Thank you very much and good morning, ladies and gentlemen. Welcome to Life Healthcare's investor presentation where we will discuss with you the proposed sale of Alliance Medical Group, which we refer to as AMG. The agenda for today is I'll take you through the proposed transaction summary and the strategic rationale that backs it up. Pieter van der Westhuizen will then talk to you about how we intend using the proceeds that come from the sale and some of the conditions precedent and warranties that need to be satisfied for this deal to conclude. And then I'll wrap up with some prospective conversations around what we think Life 2.0 will look like post the conclusion of the transaction and some of the transaction timelines.

If we have a look at the overall of the transaction timelines, if we have a look at the overall transaction itself, this is the conclusion of a particularly rigorous board process. We've spoken at length to the market about the unsolicited proposals that we received to acquire Alliance Medical Group. It was never our intention to sell the asset. We didn't put it up for sale, and we didn't cast any doubt around our ownership of Alliance Medical Group and its prospects.

However, as we explained from a fiduciary and executive perspective, if you receive offers for assets, you have to take those offers seriously, if they are serious, and you have to evaluate them. I had said on previous occasions that all assets are for sale at the right price, and this rigorous process was not just about price. We had many other things to evaluate and hence the amount of time it has taken us. We have concluded an SPA and transaction agreements with a signature date of 5 October. And we’re delighted to be doing business with Icon Infrastructure.

The perimeter of this transaction is a sale of 100% of the issued share capital of AMG. But it's important for us to note that we demarcated AMG by excluding Life Molecular Imaging. We refer to that as LMI. And it's important because when we talk about the prospects for this company, LMI has an important role to play. The proposed purchase price places an enterprise value on AMG of £910 million, at yesterday's exchange rate a shade over R21.3 billion. That derives to an equity value of just shy of £600 million, more specifically £593 million, with a Rand equivalent of just short of R14 billion after Alliance Medical Group's debt.

The intended net use of proceeds is a key part of our discussion, the detail of which will follow, but we think there will be net proceeds amounting to £462 million after we repaid our international debt component and the transaction costs, which leaves us with approximately R2.4 billion for our growth initiatives and about R8.4 billion for distribution to shareholders. And one will appreciate at this particular juncture, those amounts are approximate.

We have conditions precedent to the closing of this transaction. It is a category one transaction which requires greater than 50% support on an ordinary resolution of the shareholders of the company to be held in due course. And there are other regulatory and other approvals across various jurisdictions, which are typical for a transaction of this nature. The Life Healthcare shareholder meeting is envisaged for early December of 2023, and we expect the regulatory approvals to complete during the first quarter of 2024.

From a strategic perspective, it's important for us to be able to explain how we got ourselves to this enviable outcome. We have realised a significant premium when referenced to the implied value of Alliance Medical Group based on the sum of the parts earlier in the year. We've had extensive discussions with investors along the way, and we realised that a significant portion of the value that Alliance Medical Group holds was in the outer years of delivery. And there was some pressure from certain investor groups for shorter dated returns as opposed to longer dated holding periods.

The proposed equity value represents about 47.8% of our market capitalisation pre the February cautionary announcement. And the intended return of approximately R8.4 billion to shareholders will come via a special dividend and or share buybacks as appropriate. It's important for us to recognise and continue to recognise that AMG is a valuable asset. And this sale merely de-risks the delivery of AMG's business plan, giving a larger portion to the current date in the way of cash as opposed to realising that value in the outer years over an extended period of time.

As I mentioned earlier, 100% of LMI remains with Life Healthcare. The proposed transaction will result in a material reduction in the group's gearing. Consequently, we see improved returns and improved cash conversion metrics for both the group and the remaining businesses. We will be flexible from a balance sheet perspective, our level of resilience increases, and we will have an improved cash generation ability. Post-implementation, Life Healthcare will be positioned as a leading diversified integrated healthcare services provider in Southern Africa with the optionality to extract value internationally from our LMI operations.

We believe that this transaction gives us expanded headroom to accelerate our already identified growth initiatives, including our integrated care strategy in Southern Africa and the optionality to which we refer in Life Molecular Imaging. I'll now hand over to Pieter who will take us through the use of proceeds, conditions, precedent and underlying warranties.

Pieter van der Westhuizen [Group Chief Financial Office of Life Healthcare]
Thank you Pete. Good morning everyone. As Pete stated, the enterprise value on a post-IFRS 16 basis of £910 million at yesterday's exchange rate of R21.3 billion. We will first settle all international debt, pay back the

transaction or paying transaction related expenses of £31 million. There are some accelerated incentives arrangements for the AMG staff that we will also settle as part of the proceeds. Equity value in total of £593 million or R13.8 billion. And then the intention is to bring back the net proceeds to South Africa in terms of our Reserve Bank approval process. That quantum is £360 million that we intend to distribute to shareholders, plus the £102 million that we intend to retain for future growth opportunities. That will come back to South Africa. And we will then evaluate during the first quarter of next year, and post that we will evaluate how much will be distributed back to shareholders, but the intention is £360 million pounds.

In terms of conditions precedence, mainly regulatory in nature, as Pete stated. Because the transaction is a category one transaction, we require 50% of Life Healthcare shareholders to approve a transaction. In addition to that, Alliance Medical Group is a guarantor for all our debt packages, and we need to release Alliance Medical Group from this debt package. And to that extent, we need a noteholder a resolution for our bond programme, as well as the loan and banking agreements need to release AMG as a guarantor for the existing debt arrangements.

From a regulatory approval perspective for the purchaser, there is merger control clearance required in Ireland and foreign investment clearance required in Austria, Germany, and Italy. This is a fully insured transaction, so there's a comprehensive warranty and indemnity insurance policy in place. Life Healthcare Group Holdings will remain as a guarantor under the SPA related to fundamental warranties. It's specifically for the title of holding of the business as well as capacity for the business in terms of solvency. No concern on that part. And then there's limited set of indemnities that are also being provided relating to tax governance. I'll hand you now back to Pete in terms of Life 2.0.

Peter Wharton-Hood
Questions have been asked what this means for our business. The first point to make is this has absolutely no impact on our Southern African operations, which continue along the lines that they've been run previously. However, there are different growth differentiators that we will now refer to that require some discussion as we now have the capacity to accelerate what we previously identified as differentiators. Those investors that are familiar with the company have seen this slide before, so I don't need to explain what we think our enablers and capabilities or business lines are.

But in focusing on our differentiators, given the recently concluded network relationships or funder deals that we've done, we are now the leading network provider and funder partner of choice in South Africa. You have read about our ambition statements in renal and the launch of our integrated care product in renal has the capability to scale across this expanded network via our FMC acquisition [51 of Fresenius Medical Care's southern African dialysis centres], which is still subject to competition regulatory authority approvals.

We also have developed the capability within Life Healthcare in South Africa to develop other integrated care products, which are well on track. We have an oncology strategy which we now have the firepower to be able to roll out across the country, starting principally with the specialised institute at Life Vincent Pallotti Hospital and other regions to take care of that thereafter. We have progressed our diagnostic and imaging ambitions, both through the acquisition of the non-clinical assets of ECR [East Coast Radiology] and EMR [Eugene Marais

Radiology], and the favourable ruling that the HPCSA ruled in our favour more recently, allowing us to expand that with some vigour.

You'll have also heard about our acquisition of a nuclear medicine business named TheraMed, which becomes one of the cornerstones of our nuclear medicine ambitions in South Africa, and the opportunity for us to be able to expand an early diagnostic and imaging network therefrom.

In terms of radiopharmacy, we broadcast our joint venture with ALSIA and the building of the two cyclotrons in Midrand, which are now well progressed. In that regard, it's important for us to also explain that whilst we are disposing of 100% of our interest in Alliance Medical Group, we have concluded ongoing support agreements between AMG and Life Healthcare, both in the support of our molecular imaging strategy domestically and in the manufacturing distribution in NeuraCeq in Western Europe. So, this is not just a disposal of an asset, it's the formation of an ongoing relationship, which we are proud to do in conjunction with Icon Infrastructure, as we believe that together, we have the expertise and capability to be able to grow and develop that component of our business professionally and with expertise and at some pace.

In all, what this is telling us is that Life 2.0 doesn't require dramatic change in what the business does, but it will bring an incremental focus on our South African ambitions and the opportunity to be able to concentrate not only on the efficiency of our acute hospital operations, but the growth and development of the ancillary pillars outside of our acute hospitals, which we believe we have both the expertise and now the financial capabilities to accelerate and do it well.

In the context of Life Molecular Imaging, this has been an ongoing discussion over the last 18 months. We've been blessed with favourable news flow in relation to regulatory approvals in this particular care pathway, and I reiterate that Life Healthcare sees a significant growth potential in revenue through Life Molecular Imaging's radiopharmaceutical portfolio internationally. We have all acknowledged that Alzheimer's is a global healthcare challenge. We've also acknowledged and accept within Life Healthcare that it's essential for us not only to invest but to prepare well for LMI's role in this care pathway.

The positive news flow that I referred to is around the recent drug approvals in the U.S. Additional drug approvals are on the way in Europe, Japan and China, which indeed will bolster the demand for the diagnostic. We will invest over the next 12 to 18 months to ensure that we have the capabilities to benefit from this opportunity. And we've got a pipeline of investments on a stage-gated basis to make sure that we are correctly positioned in the medium term. I refer to the timelines below, which you can read at your leisure later on. But all in all, we have a fundamental belief in both the positioning of LMI, the value that NeuraCeq will bring to the Alzheimer's care pathway, and the global demand that will be put in place for our diagnostic treatment.

With that, it is with a sense of optimism that we report on a favourable transaction, a transaction that we believe is in the interest of shareholders. We believe that we have chosen in Icon Infrastructure a particularly professional partner that will not only honour the partnership obligations that are written into our transaction agreement, but they will also be an employer of choice for the employees in Alliance Medical Group that we hold dear to our heart. Alliance Medical has contributed significantly to the value uplift in Life Healthcare over the past six years. We're proud of the asset and the knowledge contribution that they've given us in diagnostics, imaging, radiopharmacy and PET-CT will prove to be invaluable in the creation of value in Life Healthcare in the near future.

The salient dates to which we refer to are now the detailed terms announcements which we signed yesterday. The distribution of the circular will be in early November. The general meeting of shareholders will be in early December. Regulatory approvals approximately 12 weeks thereafter and the finalisation and closing in the first quarter of 2024. With that we will now take questions.

Operator
Thank you sir. Ladies and gentlemen if you would like to ask a question please press * and then 1 now. If you decide to withdraw your question, please press * and then 2. Again, if you would like to ask a question, please press * and then 1 now. The first question we have comes from Roy Campbell from RMB Morgan Stanley. Please go ahead.

Roy Campbell
Good morning. Thank you and congratulations. Firstly, just the timing of the allocation of capital to the growth initiatives. What have you assumed over there and in your guidance for the South African balance sheet to be 1x geared, is it assumed that that capital has been allocated or is it on balance sheet?

Pieter van der Westhuizen
Morning, Roy. In terms of the timing of that, we estimate that the growth initiatives if close happens in the first quarter, will be paid in the second quarter. The two items are imminent. And in terms of the de-gearing, it is excluding the retention of the £100 million. It’s excluding from that number. So, it's purely just based on the South African balance sheet as it stands now.

Roy Campbell
Okay, thank you. I'll leave it there. I have got one more question, but I'll just pass it on.

Operator
Thank you, sir. The next question we have comes from Alex Comer from JP Morgan. Please go ahead.

Alex Comer
Hello. So, a couple of quick questions. One, can you just tell me, before you pay the £360 million, where do you think your net debt and leases land? So, obviously you've closed the year, so when the money's coming in and you've paid everything out, what is your net debt position overall and what is your lease liability overall in Rand?

Pieter van der Westhuizen
It's roughly about R4.5 billion, Alex.

Alex Comer
What, together?

Pieter van der Westhuizen
Together, yes.

Alex Comer
So, that's the leases and SA debt, yeah?

Pieter van der Westhuizen
Yes.

Alex Comer
Okay, cool. And then you talked about share buyback or special dividend as appropriate. Can you just tell me what you're thinking on not just giving the whole lot as a special dividend and what we might expect to see between the two?

Pieter van der Westhuizen
Alex, it's to be opportune in terms of the allocation, so we've decided that the total quantum will be £360 million and we will want to retain the optionality of what method will be allocated back to shareholders. We haven't made the final decision in terms of a quantum that we will split between the two.

Alex Comer
Okay, and the timing of this?

Pieter van der Westhuizen
We estimate between within 90 days after close we will start with the process.

Alex Comer
Okay. All right. Thanks.

Operator
Thank you. The next question we have comes from Anuja Joshi from SBG. Please go ahead.

Anuja Joshi
Hi. Good morning everyone. Thanks for the presentation. I missed the last few minutes of Peter Wharton-Hood, so I'm not sure if he covered this question. So, your agreement is a binding agreement. Is there a break-free applicable in the transaction? If yes, how much? And if the break-free is applicable if shareholders do not approve the transaction.

Pieter van der Westhuizen
Anuja, in terms of a break fee, it depends on certain aspects of a transaction that we don't expect to materialise. And hence, at this stage, I don't think we will share any details of that because we think that the transaction will conclude.

Anuja Joshi
Okay. Thanks, Pieter. And just in terms of your growth initiatives, so you did indicate the timeline for that. So, what sort of hurdle rate will be applied in making those investments and when do you expect growth initiatives to generate profit?

Pieter van der Westhuizen
Sorry, you broke up there.

Anuja Joshi
Hi, so just in terms of growth initiatives, so you are making investments of £102 million. What sort of hurdle rate will be applied in making those investments? And when do you expect growth initiatives to generate profit?

Pieter van der Westhuizen
So, the growth initiatives consist out of two components. One is the potential [FMC] renal acquisition that, as I stated, we expect to close out between Q1 and Q2 of next financial year, or next calendar year. That is obviously going to attract a hurdle rate in terms of what we stated previously as between a WACC plus 2% to 4%. In terms of the remaining balance, it will be for funding of LMI. And LMI at this stage is just in terms of setting the business up for the future opportunities. Unfortunately, I can't share the split with you at this stage in terms of how much will be allocated to LMI and how much will be allocated to Fresenius.

Anuja Joshi
Okay. Thanks, Pieter.

Operator
Thank you. Ladies and gentlemen, just a final reminder, if you would like to ask a question on the conference call, please press * and then 1 now. We have a follow-up question from Roy Campbell. Please go ahead.

Roy Campbell
Thank you. Just in terms of head office costs or corporate costs that sit in the centre, how much of that can you allocate back to AMG?

Pieter van der Westhuizen
Roy, in terms of currently, there's a combination of costs that we allocate to AMG. There's a management fee for certain services that we provide on their behalf. There is a guarantee fee that they pay because they currently utilise the balance sheet of the group. And then there's various IT related fees. In terms of a guarantee fee and the IT fees, they will continue until closing. And thereafter it will stop. In terms of the management fee, it’s on a similar basis. In terms of quantum, it's roughly about R100 million.

Roy Campbell
Thank you. Thanks, Pieter.

Operator
Thank you. The final question we have on the conference call is from Nick Krige [?] from Signal. Please go ahead.

Nick Krige
Yeah, thank you for taking my call. I was going to push a little bit harder on the head office costs. To me, the run rate looks to be R1.4 billion a year, and it seems very excessive. One is trying to get one's arms around why head office is costing so much when most of the activity is happening at the hospital level, and there's a management team for each hospital. So, head office should have a very small role to play in the activities of a company. So, can you walk me through why your head office costs are so high and explain to me why those can't come down as a result of this transaction?

Peter Wharton-Hood
Nick, hi. It's Pete here. I think we need to be careful how we categorise head office as head office costs. The structure of Life Healthcare is not completely divisionalised down to hospital level. There's centralised activities that take place in, let's call it, Rosebank as opposed to head office. Centralised IT, centralised collections, centralised patient services, centralised HR, centralised finance that carry out significant functions on behalf of the hospitals. The more appropriate way to do the analysis is to say how much of the costs that sit in Rosebank relate to the listed company itself and the regulation thereof? How much of the costs in Rosebank sit as a result of aggregating subsidiary activities? And how much of it is a result of centralised operations?

In the context of what one would normally refer to as head office activities, I think it's more appropriate to look at what the costs of the holding company are and the costs of the listed company are. And in that space what we can say is that Alliance Medical Group of itself has been largely self-contained in the overheads required to run the Alliance Medical Group with limited centralisation of activities and limited oversight other than Pieter and I sitting on the board and some of the centralised functions being carried forward. So, the regional structure of the SA Hospital Group is a more appropriate conversation to use as the title as opposed to head office costs. And we will be forthcoming with progress on that in the next six months or so as we re-look at our regional structures and the allocation of responsibilities between Rosebank and the hospitals and the growth initiatives themselves.

Nick Krige
Okay, thanks for that. I've got a follow-up question on LMI. And it's difficult for me to get my arms around exactly what LMI does, what exactly is its business model. But for me, it seems to be a marketing and distribution company. A lot of people have the NeuraCeq IP, and so we're really just a marketing company, a distribution company. And that's a very competitive space and a very difficult space to make money in. Maybe I misunderstand the business model. Maybe you can expand on that a little bit more for me.

Peter Wharton-Hood
Yes, I think your first assumption is incorrect. The IP sits purely with LMI, and it is near but impossible to replicate cost effectively. Given the history in this company, you'll realise that to make the IP happen in LMI costs north of $200 million. And the replication thereof is not… even if people wanted to do it, it's not

necessarily easy to start it from scratch. So, I think we're in a safe harbour space that the IP underpinning NeuraCeq is particularly valuable.

You are right in that it's a marketing and distribution company in the sense that the actual manufacturing activity of NeuraCeq takes place in the cyclotrons and LMI of itself now doesn't own any of the cyclotrons. However, it does have preferred relationships with the manufacturers and it's symbiotic in the sense that the manufacturers need to keep the cyclotrons working and the owners of the IP need to see their product being manufactured. So, in this particular space, the Life Molecular Imaging model per se in NeuraCeq is to ensure that it is the diagnostic of choice when patients are referred for PET-CT scans to confirm the clinical diagnosis of Alzheimer's.

So, in that regard, the sales and marketing arrangements concluded in more than 50 countries around the world still have to find their traction. And you are right, we are managing a pharma sales business. It is competitive, but we believe we have a particularly competitive product in LMI which owned north of 80% of the world's market share in the clinical trials that were conducted. So, it's well proven. It is a go-to isotope of choice. It's up to us to make sure that we turn that into money.

Nick Krige
Just to clarify, there are other competitors who have a similar product. So, doesn't it become who's got the best economies of scale now? And one wonders whether you have the economies of scale to compete.

Peter Wharton-Hood
Exactly, it's not just economies of scale, it's actually relationships in the referral pathways. And if you take the competitive landscape of the United States, the actual distribution of the isotope is in the diagnostic and imaging centres. So, our clients if I can call it that, are the diagnostic and imaging centres themselves. And to cover the market of the USA, that number is about 1,400 approximately. So, this is less about economies of scale. It's more about precision and making sure that it is the drug of choice as opposed to a random selection of one of the three competitors in the space.

There are other alternatives to the diagnostic in Alzheimer's, which you also have to be aware of, one of them being the traditional lumbar puncture or cerebral spinal fluid tap. And as the market progresses more to PET-CT, which is less invasive and more accurate, we need to make sure that we harvest our reasonable share of the market. Our plans are not to own 80% of the global market share of this particular space, because that would be unrealistic. But we're really backing ourselves to find our way into owning a third of it. And that's the hypothesis around which the management plans and actions have been set up.

Nick Krige
Okay. Thank you, Peter, and well done on the transaction. Thanks.

Operator
Thank you. There are no further questions on the conference call. I will now hand over to the team for any webcast questions.

Peter Wharton-Hood

The one question on the webcast around the logic about keeping LMI. There are some vertical integration benefits that could have been sought within the Alliance Medical Group. However, at this particular stage in the development of the care pathway, we're only now starting to monetise commercial sales of the product, and any valuation of LMI at this particular point is particularly difficult. And we're backing ourselves to turn this into a valuable asset as opposed to giving it away for next to nothing in the early stages of its development.

A question around does the sale of AMG affect the SA radiology practice acquisition strategy? I think that in fairness we've had the chance to transfer most of the required IP to be able to progress our radiology strategy. The disposal in of itself does not hamper the further development of the radiology strategy itself. And reference must still be made back to the continuing relationships that we've established in the sale transaction where the Alliance Medical Group will be offering services and expertise back to the Life Healthcare Group for an 18 month period of time, more specifically in the diagnostic space. Pieter, have you got one?

Pieter van der Westhuizen

Yeah, there is a question in terms of are you going to recognise a profit on the sale in the income statement? We sit in the precarious position that the transaction has been concluded after our year end date in September. So, for the 2023 financial year, it will be treated as an asset held for sale. And the transaction costs and all of that need to be expensed. And only once a transaction is concluded will a profit or loss be recognised in the following financial year. So, it will be split in two financial years.

Peter Wharton-Hood

We also have a question as to the rationale for the retention of the £102 million as opposed to distributing it immediately to shareholders. In the context of making sure that we have appropriate capital allocation methodologies and that the de-geared balance sheet of Life Healthcare is appropriately structured, that is our current estimate of what would be appropriate to retain for the growth initiatives that we have in mind to make sure that they have the appropriate funding both from an equity and a debt perspective. And that is why it's been earmarked for retention.

In the context of another question around what do we think the range valuation for LMI is, I don't know. It is a fair answer, and neither do any of the merchant bankers that we've canvassed around the world, their professional opinion being it's a little bit too early to be able to put anything on the table just yet. Sorry, we're just going through the remaining questions of the webcast.

A question has been raised as to why Icon Infrastructure was the chosen partner with regards to the strategic alignment. A multiplicity of factors that arrive in getting to that outcome. One is the professional conduct of the team during the course of the extensive negotiations and due diligence. We established a deep professional respect for one another in that promises that were made were honoured, and the professional execution of the transaction and the commitment, both to the underlying businesses, and the future outcomes that we see as beneficial to both parties was bought into at a high level, and hence our confidence in having Icon Infrastructure as a partner in those arrangements going forward.

Pieter van der Westhuizen
A question in terms of is there any tax due on the sale? No, there's no tax due on the sale. All the numbers that we've disclosed here are our estimates of the net proceeds that will flow.

Peter Wharton-Hood
The net debt to EBITDA target?

Pieter van der Westhuizen
In terms of net debt to EBITDA target, our covenant is at 3.5x and it will remain at 3.5x. Obviously, with the disposal of AMG, our internally set targets we will reduce. As we stated, post the transaction, it will be roughly about 1x. And we are trying to retain it at appropriate levels. But as I stated, around 3.5x is a covenant.

Peter Wharton-Hood
I think, operator, that we've covered the questions that have been asked of us, unless there are any more questions.

Operator
At this stage, there are no further questions on the conference call either.

Peter Wharton-Hood
At this particular point, I'd like to thank you for joining the call, and from an executive perspective, my expression of thanks to both our partners, Icon Infrastructure, our professional advisors, and all the executive teams and staff through the last eight months of work that have resulted in this transaction. A huge thank you to all of you and thank you very much.

Operator
Thank you, sir. Ladies and gentlemen, that then concludes today's conference call. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT