Conference call transcript

16 November 2023

SUMMARISED GROUP RESULTS FOR THE YEAR ENDED 30 SEPTEMBER 2023

Peter Wharton-Hood (Group Chief Executive)
In the context of our overall results, we start with a strong underlying performance of our businesses. In South Africa (SA), revenue grew by a shade over 10%, normalised EBITDA by 6.6%, with paid patient days rising by nearly 10% during the course of the year. Life Molecular Imaging (LMI) had a strong performance with revenue growing by 18.2%. Off the back of news flow during the year, PET-CT is now being reimbursed in the US for Alzheimer's disease care pathways and NeuraCeq® also received approval to be used in China.

The Alliance Medical Group (AMG), which we will discuss in more detail later on, as the discontinued operation that we've sold, saw a growth in revenue in excess of 10%. We have reported that we have sold the business for £910 million. The shareholder vote to approve the transaction will be on the 8th of December of this year and we expect to close out all the conditions precedent by the beginning of quarter two of 2024.

Overall, the group's revenue is up 10%, normalised EBITDA is up 4.4% with normalised earnings per share improving by 11.4%. We will declare a final dividend out of continuing operations of 27 cents.

In our review of the Alliance Medical Group's performance, we see this as a positive transaction to sell the business as it unlocks significant shareholder value. We announced the transaction on the 5th of October 2023, valued at an enterprise value of £910 million. We will use the proceeds to settle all our international debt and pay for the transaction costs, the balance being repatriated to South Africa. We anticipate distributing in excess of R8 billion to shareholders early in 2024. We will retain about R2 billion for further growth opportunities and we have already earmarked those specifically for Fresenius renal-based transactions and further investment in Life Molecular Imaging. The net proceeds have already been hedged by a deal-contingent forward, and whilst the transaction is subject to a few conditions precedent, we do expect these to close out early in 2024. I must reiterate again that this disposal does not include Life Molecular Imaging.

After the transaction is completed, our net debt to EBITDA ratio will be below one times. When we look at the underlying performance in Alliance Medical Group for the year, it delivered strong growth in volumes. And whilst we held it as an asset classified as a discontinued operation, it is fair for us to report that the overall performance came off a volume growth of 7.3%, with the UK volumes up 9.5% and Irish volumes up 13%. Revenue grew by 10% and normalised EBITDA grew by close to 6% to £83 million during the year.

When we talk about Life Molecular Imaging, it's important to note that the NeuraCeq® opportunity is gaining momentum. Our sales of NeuraCeq®, which is the primary driver of LMI's revenue, grew by 18% to R656 million for the year. Clinical trial revenue was up 7.7%, commercial sales up 29%. There is, however, still a reported EBITDA loss in the division, primarily off the back of our investment in the sales and marketing team to drive NeuraCeq® sales. Headcount in the division rose to 122 people off a base of 104 last year. And we've extended the agreement with AMG to continue manufacturing and distributing NeuraCeq® in Europe. The table to the right-hand side shows the extent to which we've already achieved our global presence for NeuraCeq®, where we have 44 active and contracted sites to manufacture NeuraCeq® around the world. And the bottom right-hand portion of the slide starts to show the most important metric by which we will judge NeuraCeq® success, and that is the sales of NeuraCeq® doses, be they commercial sales, clinical trials, or those used in R&D. I'll now hand you over to Adam Pyle to take us through the South African results.

Adam Pyle (CEO – Southern Africa)
Thank you, Pete. So, in terms of the South African overview, I'll talk about our underlying activity growth. I also need to touch on the change that we are seeing in the medical aid market. I'll talk about our acute and complementary lines of business and how that feeds into our results. Then I'll end with some commentary on our capital allocation in 2023.

We had a really strong year in terms of our underlying activities. Overall PPDs grew by 9.5%. This is off the back of our acute hospital PPDs growing by 10.2%. Mental health and acute rehab PPDs up 6.8%. Resulting in our overall occupancy percentage being 68.1%. And if you look at the graph on the bottom left, the occupancy levels, you´ll see firstly for 2022 to 2023 our acute hospitals had an occupancy from 61.1% to 67.6%. So, really good growth on the occupancy level there.

We saw good growth in our complementary services, with occupancies being just below 73%. And overall occupancies increased from 61.9% to 68.1%, so really good growth in occupancies, and getting close to 2019, and I'll touch on that a little bit later. This growth is really driven by the continued recovery post-COVID, but a really strong performance from our network deals, particularly with the introduction of the two significant networks from January this year. We've also seen good doctor recruitment and some additional beds added. In addition to the PPDs, we saw good business growth from our renal dialysis business, oncology business, and also from our imaging business, which has been in our results for the first time for a 12-month period. And if you look at the graph in the bottom right, which covers our revenue, you will see that there's a good improvement in our complementary services revenue to just over 1.6 billion. I think it's 20% growth. And this is off good growth in complementary service business lines, as well as a strong performance from imaging. We are quite confident that the growth going forward in complementary will be strong over the next three to five years.

If one moves on to look at the market. Although the market is flat in terms of lives, there are some changes happening within that. And the first trend we're seeing is that the percentage of members belonging to preferred networks continues to increase. And you can see from the table on the top right that the percentage of our PPDs from networks has grown by 50% since 2019. We do expect this trend of more members belonging to preferred network deals to continue going forward. And as such, as a company, one has to work out how one operates within this market and how one deals with preferred networks. Our strategy has always been fairly clear – that we want to be the number one hospital group when it comes to referred network lives. The benefits we see coming through this year in a flat market are the improved occupancies.

We do understand the impact that this has on our revenue per PPD and the impact it has on margins, but we believe that the higher occupancies give us better scope going forward in terms of how we manage our costs.

Looking at the second point is the ageing Medicaid membership. Within the schemes, you look at the charts, you can see there's a reduction in members between the ages of 20 and 34, and there's an increase in members over the age of 60. And how that plays out in terms of our admissions is that we've seen our average age of admissions increase to 45 years from 43 in 2019, which is quite a significant shift in just four years. And if you look at the table on the bottom right, you'll see that our PPDs for the age of 20 to 39 are down 19% since 2019.

Our PPDs for the 60 plus years are up 3.9%. Just for context, the PPD category of 60 plus years is much bigger than the 20 to 39 years, but it does show the difference in terms of patients, the type of patients coming through to our facilities. And that plays out in terms of the case mix. So our births are down 5%, but our cath lab [cardiac catheterisation laboratories] cases are up over 23%. And you can see the increase in volume of knee replacements and hip replacements. So we are seeing a different case mix playing out. And we've been watching this trend for a number of years, and we are busy shaping our business accordingly to take into account this change in demographics.

Looking at our acute hospital business, we have some strong growth in revenue of 10.3%, driven by an 8% increase in admissions, and PPDs are growing by 10.2%. What we're seeing is a length of stay increase of 2% to 3.8 days per admission. This is about 9 to 10% higher than it was pre-COVID. And it's reflective of the case mix, the faster growth in medical PPDs, as well as the ageing population I've just spoken about. And if you look at the split between the PPDs, you can see medical PPDs excluding COVID-19 grew by over 20%. Our COVID PPDs, it should be a sort of red arrow pointing down, is down by 73%, which is expected. And our surgical PPDs are up 10.1%.

So this year, we did see a case mix change, going back to more of a normalised case mix, but that case mix change of more medical and less surgical did result in a lower revenue per PPD coming through. Good growth in theatre minutes, and I've covered the cardiac activity and births. I do want to touch on the occupancies, and you can see the pie charts on the right. Although occupancy is not that far off 2019, when you look at the split, there's still quite a big difference. And so in 2023, we still have 19% of our beds with an occupancy below 60%. And this compares to 9% in 2019. And we only have 3% above 80 compared to 13%.

So, our strategies apart from increasing occupancies to make sure we get the right mix and more of our occupancies and beds above 60%. And that's key for us going forward. In addition to that, I just want to mention that our ICU occupancies are over 80% for the year, so higher than 2019 at 76%, and that's reflective of some of the case mix we see coming through. We also had an excellent year in terms of our doctor recruitment. And it's not just the number of doctors recruited at 104, which are net additions, it's the type of discipline of doctors that we're recruiting, which fits into how we're sort of reshaping parts of our business to deal with the changing and ageing demographic.

Moving on to our complementary lines of business, which really had an excellent performance for the year with revenue growth of over 20%. This was built on the PPDs growing by 6.8%. We had mental health up by 8.4%, acute rehab 3.3%. For that 3.3%, we have excluded the closure of our one acute rehab unit in Bloemfontein. We saw good growth in oncology and renal dialysis. And the slides that points to x-rays and MRI, CT and PET-CT, percentages are high because they're in for 12 months, whereas in the prior year, I think we had East Coast Radiology in for seven months and Eugene Marias Radiology in for one month.

What's more interesting, I suppose, is if you look at the point on the top right about our underlying MRI and CT scan volumes growth. So it's on a 12 month comparison from FY23 to FY22, those underlying volumes grew by 14.6%. So, we've had a really strong performance from our imaging business and it certainly exceeded our expectations and becomes a key growth area for us going forward.

This feeds into our segmental breakdown. You can see our revenue up 10.1%, and that's between hospitals and complementary services growing by 11%,and our healthcare services down by 2.7% on the revenue line. We had a strong performance from Life Nkanyisa, and the reduction of revenue is primarily due to Life Health Solutions.

And it's how we're focusing our attention and making sure we have the right contracts in place. The benefit we can see coming out in the normalised or operational EBITDA line. So operational EBITDA grew by 7.7% with hospitals and complementary services growing by 7.1% and healthcare services, as you can see, growing by 22.7%. So the good performance from Life Nkanyisa and our reshaping of the Life Health Solutions business is starting to gain some traction. Just in terms of the corporate costs, which Pieter will deal with a little later in the finance section, there has been continued investment in our value-based care products, which are essential to us going forward in terms of how we reshape the delivery of healthcare in our company, our IT infrastructure and our platform, as well as investment into data analytics.

Just in terms of our last slide, this last year we spent over R1 billion on our maintenance and it's really an investment into our portfolio and our assets. On top of that we have been focusing our growth in facilities in areas that benefit from the market changes. What you see is an increase in ICU and high-care beds, a focus on emergency units, cardiology, oncology, renal dialysis, etc. That trend you will see going forward as we carefully map out how we grow our business in a market which shows very little growth from a membership perspective. We continue to invest in our technology. We completed the modernization of our underlying IT infrastructure. There's been continued investment into our IT platform, systems, security and cloud storage. We've made good progress this year on those factors.

And then finally, just on our acquisitions and disposals we completed the acquisition of TheraMed Nuclear and PET Vision. These are three outpatient molecular imaging sites, and this is part of our strategy of building a countrywide PET-CT network, and that process will continue in the next few years. We're with the Comp Com [Competition Commission] in terms of the Fresenius Medical Care acquisition, and we're just awaiting, hopefully, approval from the SA Comp Com, after having received approval from the other two territories.

Then we continue to look in our portfolio of assets, and we close one birthing [maternity] unit, and we also closed an acute rehabilitation unit. We continue to review our portfolio going forward.

And then just finally, there's one point I'd like to mention. I'd just like to thank all our staff and our management and our doctors for the hard work and the quality of care they deliver to all the patients that come through our hospitals. On that note, I will handover to Pieter.

Pieter Van Der Westhuizen (Group Chief Financial Officer)
Thank you, Adam. Good morning all. The results for 2023 reflect a good operational performance and especially a strong activity growth from the southern African operations. The strong activity growth in SA with PPDs growing at 9.5%, largely as a result of network gains and the revenue growth in LMI of 18% results in group revenue from continuing operations growing at 10.3%. Normalised EBITDA in SA grew by 6.6%. It's lower than the growth in revenue, and as Adam stated, this is due to a number of factors, increased costs in corporate, as well as case mix change, and lower revenue per patient in the southern African operations. The EBITDA loss in LMI, then resulted in normalised EBITDA growth from a group perspective at 4.4%.

Earnings for the group have been impacted by a number of non-trading related items. Some of them we disclosed in the half year, but the largest one is the AMG impairment and transaction-related costs that we had to disclose as part of discontinued operations and which reflect in the current period – the R990 million loss, and I'll talk about that in the next slide. Contingent consideration in the prior year, we released a contingent consideration that was payable on LMI to the tune of R457 million. It made it difficult from a comparative basis in the current year. We settled the tax matter in the current year and so in the current year there's a charge of R47 million and in the prior year an accrual of R199 million. So, there's a net gain in the current year.

The best metric that we think you need to look at from an earnings per share perspective is normalised earnings per share, to strip out these non-trading related items, and that grew by 11.4%. That's also the metric that we use to determine the dividend.

We had strong cash conversion and earnings growth, as I stated, on a normalised basis. The cash generated as a percentage of normalised EBITDA is above 100%, above our metric of 95%. And it was an exceptionally good job, specifically in the SA operations after the half year, where we had the impact of a failure at one of our service providers that impacted our ability to bill and collect cash, and that they recovered most of that money. Net debt to normalised EBITDA is at two times. It does include the debt that we intend to repay as part of the disposal of AMG. When the disposal goes through in the new calendar year, net debt to normalise EBITDA will be below one times.

The total dividend for the year increased 10% to 44 cents. On AMG, as Pete stated, we disclosed it as a discontinued operation. The R990 million is made up of a profit after tax loss of R19 million, largely driven by an increased finance cost in the AMG business, but it had a good operating performance with operating profit increasing by 20%. Transaction costs already incurred of roughly about R150 million, as well as in the impairment that includes additional [future] transaction costs to a tune of about R550 million.

The strange thing with IFRS 5 is you need to fair value the asset, but you can't bring in the unrealised gains on exchange rates. That will realise when the transaction closes. As at the end of September 2023 the unrealized gain was R2.9 billion. So, a potential profit, if the transaction had to close out on 30 September, would have been approximately R1.9 billion.

Segmental results excluding AMG. Just want to show you at the bottom right-hand side of the slide, as Adam stated, the income grew in corporate by 15.3% and the corporate costs grew by 18.8%. I'll talk to you on the next slide in terms of the implications of that. Life Healthcare runs a centralised service operating model in southern Africa, where we perform a large number of services on behalf of the business operations. These include central finance, debt collection, patient services, payroll functions, and the like. The centralised service costs increased by 22%. It does include an increased insurance pool that we're creating to do self-insurance for our business of around R60 million. And as Adam stated, we've also increased the investment in our value-based care products and our data analytics teams as part of a centralised services. If you strip out the insurance cost, the centralised services increased by 10% only.

IT, that's a function of two factors. One is the increased utilisation of applications by users. So, as we bring more users to the digital environment, it does have an implication on licensing costs. And the second part of that, the licensing cost is denominated in dollars largely. So, if the Rand weakens, that cost increases. And then thirdly, due to the IT incident that we had in a half year, some of our key projects for cloud migration project have been delayed. And they will now only be concluded in the new financial year. It does mean that we still have some duplicate costs coming through. That cost has increased by 20%. The two corporate costs that we can't split out to the South African operations that we service, also part of the AMG business and the LMI business is grown by 8%. Most of that costs is salary cost. Then we've got the long-term incentive plan related to the people based at our corporate offices in Rosebank of R141 million for the current year. That's the total cost of roughly about 19% increase to the R1.5 billion.

On the income statement, just want to highlight a few items. The non-trading related items, as I've stated previously, in the prior year we had R299 million, in the current year R29 million. In the prior year it's R457 million related to the contingent consideration in LMI and then offset by the SARS matter of R157 million. Profit after tax down 12.8% against last year and the discontinued operations loss of R990 million. Earnings per share, due to the discontinued operations, is quite messy. But as I stated, the one metric that we think is best to look at is normalised earnings per share from continuing operations up 11.4% to 89.1 cents compared to last year at 80 cents. So it's a like-on-like comparison.

We're still in a strong financial position. AMG, based on a net basis, is reflected as an asset held for sale of R19 billion. If the transaction was closed at the end of September 2023, we would have realised approximately R21 billion as I've reflected, roughly about R2 billion gain.

We will then utilise those funds, as we stated in the earlier communication to firstly repay the international debt of around R8.7 billion, repatriate the balance back to South Africa, service the transaction-related costs and then repay £360 million (or roughly about R8.4 billion) back to shareholders and retain about R2 billion for growth opportunities that we've identified. Net debt of R12.3 billion, as I stated, does still reflect the debt of international business of R8.7 billion. We do expect to spend R2.3 billion on capex in 2024.

On the cash flow, free cash from continuing operations grew by 78%, from R576 million in the prior year to about R1 billion. The R1 billion is roughly about 30% of EBITDA. And that's a metric that we will keep tracking going forward that we want to generate as free cash. We define free cash as EBITDA, less working capital investment, less interest, less tax, less maintenance capex and less minority distributions. That's where we've got doctor shareholdings in some of the hospital facilities and an employee share plan. That R1 billion is the quantity that we see as available for growth opportunities and for distributions back to shareholders. I'm going to hand you now over to Pete to do the capital allocation and outlook.

Pete Wharton-Hood (Group Chief Executive)
Thank you very much, Pieter and Adam. And in closing, it's important for us to express our sentiments around how we're going to spend money. Effectively, the split between growth and maintenance capex in an operation such as ours is a very important and necessary distinction. Our growth capex will deliver some exciting organic growth and innovation opportunities. We've spoken about the need to expand our ICU, high care and general ward capabilities across our acute settings, investing in renal and other value-based care products is in line with our expansion of complementary services revenue, and we will continue with the Oncology Centre of Excellence strategy.

We are also very excited by our diagnostic and molecular imaging strategy, and we're in the process, as we've reported earlier, of building the two cyclotrons in Gauteng and will expand a PET-CT network in South Africa in due course. Internationally, there's a small capex requirement for manufacturing kits for NeuraCeq® at the cyclotron manufacturers themselves. And we will seek additional approvals in other markets to be able to market NeuraCeq®, as well as invest in the pipeline investments already in play in Life Molecular Imaging with the “stage-gated” manner for a new isotope under phase 3 FDA clinical trials to detect the presence of tau. Inorganic growth opportunities come along the lines of the Fresenius Medical Care acquisition in the renal dialysis space.
We've also targeted a hospital property, which we currently lease, and it is important to us that we feel that we own along with our ownership strategy for the rest of the property portfolio. We have said on all our calls that we are unlikely to pursue any international M&A transactions.

From a maintenance capex perspective in southern Africa, it's important that we both grow and sustain our existing business and our embedded footprint requires money to be spent in order to secure the organic volume growth and drive optimal occupancy levels. When that is all said and done, the excess cash is promised to be returned to shareholders by way of ordinary dividends, which we've already announced, special dividends and shared buybacks, which we've already telegraphed as a result of the cash coming from the AMG transaction.

From an outlook perspective, we are confident that we'll see increased occupancies through our hospital networks as a result of the network deals that we've concluded and the active doctor recruitment, which we are always engaged in. We're targeting a PPD growth of around 3%. We will be focused on maintaining our EBITDA margin and focussed on cost reduction activities where appropriate. In LMI, the main emphasis is to drive the commercial sales of NeuraCeq® and we'll continue to invest appropriately in the required sales and marketing teams as we expand in the United States and later on in Europe.

In conclusion, from a group perspective, we have to make sure that we deliver the AMG disposal according to the timelines promised, and we will also make sure that the cost base is optimised thereafter as a result of such a sale.

We have also promised to distribute the net proceeds to shareholders, and thereafter we will review the dividend policy for the company going forward.

Thank you very much for your attention and apologies for the challenges we faced earlier in the day to deliver this presentation to you.

END OF TRANSCRIPT