Conference call transcript

11 November 2016

ANNUAL RESULTS PRESENTATION

Operator
Good morning ladies and gentlemen and welcome to the Life Healthcare 2016 annual results presentation. All participants will be in listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference please signal an operator by pressing star then zero. Please note that this conference is being recorded. I would like to hand the conference over to the Investor Relations Executive, Mr Adam Pyle. Please go ahead sir.

Adam Pyle
Thanks very much. Good morning ladies and gentlemen, and welcome to the 2016 Life Healthcare results webcast. We will follow a similar process to our previous webcasts and we will start with our CEO, Andre Meyer, who will take you through the operational performance of the company. Andre will then hand over to Pieter Van der Westhuizen, our CFO, who will take you through our financial performance. Pieter will then hand back to Andre for an outlook. And after that we will be available for questions. So I will now hand over to Andre for the operating review.

Andre Meyer
Thank you Adam. Morning ladies and gentlemen. We are going to start off with South Africa. We had a solid 12 month performance with strong bed growth, strong activity growth and good management of costs in a difficult environment. Our PPD growth was up 4%. We have added in total 110 beds over the period. Our occupancy rate was at 72.5%, our EBITDA margin at 27.5%.

Moving on to Poland where we completed the acquisition of PGM for R629 million. In Poland we had a difficult operating environment with regulatory and pricing uncertainty, and the new tariff for cardiac procedures has negatively impacted our revenue and our EBITDA. We changed the senior management team effective 1st July and appointed a new CEO. We have also seconded three South Africa managers to help with the integration process. We have had to impair R370 million because of the change in the pricing.

On India we have seen good growth in revenue, up 16.7%, and also good growth in EBITDA, up 29.3%. The EBITDA margins in India improved to 10.9%. We added in total over the period 331 beds. And the total number of operational beds is now 2,384. We have also had good growth in occupancy rates. At a group level India is at 75%. We are over the period focused on bedding down phase three acquisitions of Vaishali and Saket Smart hospitals which is also making good progress.

At a group level our revenue grew by 12% up to R16.4 billion. Our normalised EBITDA was up 6.6% to R4.3 billion. Headline earnings per share increased by 7% to 192.5 cents. Normalised earnings per share increased by 2.6% to 182.1 cents. Total dividends were up 7% in respect to the final dividend, 92 cents per share, and the total dividend up 7.1% to 165 cents per share.

Moving on to growth, our PPD growth, we had strong PPD growth across acute care and complementary lines of business at 4%. Our acute and complementary growth number of beds that we added, capacity expansions, in acute facilities we are adding in total 125 beds. Mental health we have

added 51 beds in total for the period, which brings the total number of beds to 176 for the year. We have also added 36 renal dialysis stations and one oncology unit.

More specifically our Life Hilton private hospital we opened the facility with 94 beds in September 2015. The average occupancy in the last four months of 2016 has been 68%, having also opened the oncology unit in H2. Phase two is going to consist of an additional 100 beds which we will add for which we have license approval. And then in phase three we will be adding 70 mental health beds, 50 rehabilitation beds and 10 sub-acute beds. And the license is pending in respect of [unclear].

If we look at the impact of aging the Council for Medical Schemes' 2015 annual report shows the shift in the age profile in the medical scheme population with less members as a percentage up to the age of 50 and more members as a percentage above the age of 50, so clearly evidence of an aging population in South Africa in respect of the insured lives. The shift in aging is also reflected in our PPD experience. If you look at the PPD percentage of patients older than 50 years that has moved from 39.8% in 2010 to 45.9% in 2016. The percent of revenue earned from patients older than 50 years has moved from 46.3% in 2010 to 52.7% in 2016. The aging impacts on length of stay, ICU occupancy and changing case mix which is why we are seeing an increase in the medical cases.

The medical surgical split we have seen a continued growth of medical cases negatively impacting revenue. The acute medical surgical as a percent of PPDs, medical at 51% and surgical at 50%. The total medical surgical split including complementary services as a percentage of PPD medical at 54.5% and surgical at 45.5%. Medical revenue per PPD is 41% of the surgical revenue per PPD.

Our healthcare services business, starting off with Life Employee Health Solutions, made up of Life Occupational Health and Careways, is in a process of being integrated and will be rebranded as Life Employee Health Solutions. The combined entity consists of contracted occupational and primary healthcare services to large employee groups in commercial, industrial, mining and state-owned entities through onsite, offsite and mobile clinics throughout the country with a total of 297 occupational health clinics and 160,000 occupational lives that we service in this business. The employee wellness services to corporate customers is focusing on healthy and balanced living with 74 onsite clinics servicing 260,000 employees. And in the year we gained 65,000 lives in total.

If you look at the Life Esidimeni business in this business we have had 1,570 mental health beds that were not renewed by the Department of Health as of 30th June 2016. And the consequence of the non-renewal is the Gauteng Department of Health transferred approximately 1,500 medical health patients to NGOs. Since the transfer 37 patients have subsequently died and these deaths are currently being investigated by the office of the Health Ombudsman. Currently Life Esidimeni consists of nine facilities with 2,224 beds. We recently opened two substance abuse centres in partnership with the Department of Social Development.

On efficiency, effectively looking at our occupancy, the occupancy levels have moved from 71.9% in 2015 to 72.5% in 2016. ICU occupancy is at 75.8%. In H2 we have seen an occupancy of 73.9%. So we have had growth in occupancy despite the additional 1,065 beds we added since 2012. We also made good progress in reducing the occupancies below 60% and also above 80%. Occupancy split between acute and complementary, we have had consistent occupancy within the acute business with 860 acute beds added since 2012. We have added 205 complementary beds since 2012. We have also seen a strong demand for mental health with occupancies over 80% and we have seen an improvement in acute rehabilitation occupancies to 74%.

Our normalised EBITDA margin on a continuing basis excluding the once-off costs that we will list below was 27.9%. the once-off costs were additional legal costs resulting from increased malpractice

insurance and a legal settlement for R30 million in respect of a malpractice law suit dating back to 1995 which occurred before we acquired particular facility. The margin was also impacted by the pressure from the weakening Rand, salaries, overhead costs and the Life Esidimeni retrenchment costs.

On quality measuring clinical outcomes is a very important part of our strategy. We continue to strive to improve the quality of healthcare delivery in all of our facilities. And we are currently working on a programme to align our clinical metrics to international standards. Clinical outcomes remain the key strategic pillar for us and we will continue to strive to improve these results.

On sustainability in respect of the health market enquiry we have submitted further responses to the panel focusing on the nature of Life Healthcare's relationship with doctors, our profitability, and also we have commented on the OECD report. We are currently unsure of the timing of the next set of public hearings as we have had no feedback in this regard. We have also provided commentary on the market definition methodology paper and at this stage we are also uncertain as to when a draft report will be issued in 2016. We expect the process to continue through to 2017 and the cost involved for the 2016 financial year is approximately R20 million, and that excludes management time.

On environmental management systems, environmental certification, we have 12 hospitals that achieved ISO 14001 2004 environmental certification in 2015. Four hospitals were audited in 2016 and we are awaiting the results, and a further 10 hospitals were targeted for syndication in 2017. Our energy-saving initiatives, solar projects, at Life Anncron hospital we have installed 1,711 solar panels which produce an average of 1.8 megawatt hours per day. We have also installed at the Life Fourways hospital 3,400 panels which produce 3.75 megawatt hours per day.

Our energy saving initiatives, heat pumps, all the sites are now complete and we project an estimated saving of 1,495 megawatt hours per annum. Our power factor correction, five sites were completed in 2016 delivering a combined KVA reduction of 500 KVA per month. Our water initiatives, we made good progress in this regard with water utilisation down 20.5% to 0.56 kl/PPD. We also now have water backup storage facilities for 24 hour backups in all of our sites.

On Poland the new cardiac pricing came into effect on 1st July with an approximate 17.4% reduction in our pricing. Cardiology represents 45% of the Scanmed business. These price changes will have a significant impact on our 2017 results. Our management team, as I said earlier we changed our CEO. We appointed a new CEO effective 1st July and we also seconded three of our management from South Africa to assist with the integration process. Going forward we will be focussing on driving further efficiency in the business to mitigate the impact of the new cardiac prices. We will focus on the integration process and for now M&A activities are on hold until we have greater clarity on the pricing in that market. The Scanmed business now consists of 624 beds, 12 cardiac units, 40 medical facilities, revenue of R1.2 billion, normalised EBITDA of R120 million and an EBITDA margin of 10.2%.

Moving on to India. We focussed in 2016 in bedding down the phase three acquisitions of Vaishali and Max Smart. We improved the number of operational beds in these facilities from 260 to 494 and we grew occupancies from 67% to 72%, so good progress there. We continue to be focussed on revenue growth and improving our margins. Max Healthcare delivered strong EBITDA growth numbers for H1 2017 with margin improvement. Max India listed in July 2016 and the share price at 30th September is an approximate value of R5.3 billion for the Life Healthcare shareholding in Max Healthcare.

Max occupancy, the phase one occupancy sitting at 78%, phase two 72% and phase three also 72%. So those combined occupancies at 75% despite the fact that we had 231 beds over the period. I'm now going to hand over to Pieter Van der Westhuizen who is going to give an overview of the financial side of the presentation.

Pieter Van der Westhuizen
Thank you Andre. In terms of our financial performance Southern Africa had strong operational performance particularly in the PPD growth of 4%. Our revenue per paid patient day was negatively impacted by the continuing growth of the medical cases growing faster than our surgical cases mix. In H2 we experienced cost pressures specifically due to the weakness of the exchange rate in the first half where we had suppliers coming back to us in the second half on our critical prices. We had increased cost in malpractice costs as Andre has mentioned due mainly to a claim against us prior to us actually acquiring the business dating back to 1995. And the other impact on our South African operations was the loss of the Gauteng contract in the Esidimeni business and the impact was a R25 million loss on the EBITDA line.

The international operations experienced satisfactory operational performance but we are behind on the business integration so did not achieve the margin expansion on a like for like basis that we wanted. We had to second management to Poland to assist in this process. And we also had the impact of the tariff regulations coming through from 1st July. The impact of that was a 9 million Zloty hit to the EBITDA line, roughly R40 million. In India we had the EBITDA growth of 29.3% and in addition to that we improved margins. India is now running at EBITDA margins of 10.9%. In the early [unclear] we were impacted by the funding cost of the two acquisitions that we concluded in the last 12 months, Vaishali and Saket City. The group results were impacted by the impairment of the Polish operations to the value of R370 million. And in the funding cost for the two acquisitions that we made in Poland and India we have had funding cost that hasn't been serviced yet through [unclear] operations.

Our highlights in terms of financials, our revenue is up 12% to R16.4 billion. EBITDA increased to R4.3 billion, a 6.6% increase. Normalised EPS 2.6% up at 132 cents and headline earnings up 7% to 192 cents. I'm pleased to announce a final dividend growth of 7% to 92 cents. I will talk later about that. And then we had an increase in investments in Poland and India for the 12 months under review of R1 billion.

Revenue of 12% is broken down from South African operations at 8.8% and the EBITDA growth in SA of 6%. The factors impacting that is the once-off cost that we discussed earlier as well as the margin reductions due to the cost of sales specifically in the second half. If we strip that out on a like for like basis the margin should have been about 27.9% ignoring the once-off cost. Poland operation's EBITDA margin at 10.2% is down from the 14% at the end of last year.

Operating profits increased by 4.7% mainly due to the impact of the depreciation cost coming through in the SA as well as in the Polish operations. The Polish operations were also impacted by the amortisation charge from the intangibles associated with the acquisitions that we concluded in the last period.

Max Healthcare was the last year a small profit of R5 million, a small loss this year of R4 million. The improvement in the half year – if you remember at half year we had a loss of R7 million – the improvement is roughly R3 million for the six months mainly driven by the improved operational performance of this business. But there is still a small loss due to the funding cost coming through for the two acquisitions.

Attributable profit, the South African operations grew attributable profit by 7.6%. Stripping out the transaction costs for the international acquisitions of R12 million the international operations had a small loss of R10 million compared to a profit last year of R19 million. The biggest growth in attributable losses is the funding cost for the international acquisitions growing by 36% from R192 million to R261 million. We have repaid some of the funding cost at the end of the financial year where we utilised the

scrip saving on the dividend to repay some of the preference shares. So that benefit will flow through in the next financial year. The other main line in attributable profit is the impairment of R370 million offset by contingency considerations in Poland when we didn't have to pay dividend out to [unclear].

On the segmental basis the South African hospital division grew turnover by 9.5% and EBITDA by 6.8% due to the factors mentioned earlier. The Healthcare Services was impacted by the Esidimeni contract loss but as well on the occupational health, the only business that is impacted by the slowdown in the economy, we had a very tough year. The total impact of that is we had a 2% reduction in revenue in Healthcare Services but a 28.6% reduction on the EBITDA line.

On the hospital side we had a 9.5% revenue growth broken down between the PPD growth of 4%, revenue per PPD is up 5.2%, the tariff that we achieved in the financial year of 5.9% and a negative case mix of 0.7% due to the faster growth in medical cases compared to surgical cases. A stellar growth in complementary revenue of 17.3% for the year under review.

The South African business on a continuing basis is growing consistently. We had in the last five years a compound growth rate in revenue of 8.7% while our normalised EBITDA grew by 9.8%. In the current financial year we have added 176 beds. We have strong PPD growth of 4%. Top line growth was however impacted by the continuous increase of medical cases. And we see continued good growth of complementary services in the hospital division. Our complementary services have in revenue terms grown for the last five years by a compound rate of 20.8% [?].

Poland, although operationally was a satisfactory performance we were disappointed in terms of integration as well as the tariff impact hurt us in terms of our EBITDA margin and the profits coming from that operation. The margin dropped from the 14% to the 10.2% as highlighted earlier.

In the Indian operations we had a 0.7% revenue growth in the phase one facilities, and that is largely due to those facilities running full. The phase two facilities we had 3.9% revenue growth and a greater than 100% growth in the phase three facilities, but that is largely due to the addition of Saket City towards the end of December of last year so it's not a like for like comparison to the 2015 numbers. Overall the revenue growth in the Indian operations was 16.7%.

If one looks at the EBITDA contribution from the different phases the phase one facilities are running at 13.5% EBITDA margin. And that would be the target to get the phase two and phase three facilities up at a similar 13.5% and at the same time try to reduce the overhead costs in the operations to lift that margin. The margin is now running at 10.9%, and that is an improvement from the last year. If one looks from 2013 to 2016 the EBITDA margin from the operations improved from 7.8% in 2013 to 10.9%. So each year we see incremental improvement in the EBITDA margin. There is hard work from our management team on that side to improve the margin as well as the operational efficiencies in that business.

Earnings per share is down 13.9% largely due to the impairment of the Polish operations. The impact of that was 35.5 cents. And then if one strips out the loss from the re-measuring of previously held interest in associates, that's where we acquired the majority share in Poland, it leaves us with headline earnings up 7%. Then if one strips out the contingent consideration on the earn-out in Poland it leaves us with normalised EPS up 2.6% at 182 cents. The contribution from the South African operations in the normalised EPS is a growth of 7.2% offset by the funding costs for international acquisitions impacting 25 cents for the financial year.

We have still a low gearing. From a balance sheet perspective our net debt to normalised EBITDA is at 1.67, slightly up from the 1.49 in the last financial year mainly due to the increased investment in the

Polish operations. Our cost of funding increased from 5.76% to 6.5%, and that is slightly below the increase in the overdraft rate in South Africa. We have been able to do that through switching some of our debt into Poland as well as renegotiate some of our funding in South Africa when we repaid more of the expensive debt.

The board is pleased to announce a final dividend of 92 cents. We will do it again in the form of a scrip dividend alternative with a 2.5% discount on the 15-day VWAP. Dividend growth for the last five years is a compound growth of 4% growing from 105 cents to 165 cents. I will now hand you back to Andre to go through the outlook.

Andre Meyer
Thank you Pieter. So the outlook for 2017 starting off with Southern Africa, we will add 196 beds consisting of 115 acute hospital beds and 81 mental health beds. Our PPD growth is expected to be between 2% and 3%. EBITDA margin we expect to be between 27.5% and 28.5%. We will continue to focus on improving our clinical quality outcomes. As I said earlier it's a very important component of our overall strategy. And we expect the HMI process to be completed in 2017.

If you look at the growth in more detail, 196 beds I mentioned, 115 of those will be capacity expansion to existing facilities. Mental health new facilities will be 60 beds and mental health capacity to existing facilities will be 21 beds. We will also be adding 19 renal stations and one further oncology unit at one of our hospitals in Pretoria, Eugene Marais. We have in total 1,363 beds approved and we have 882 pending applications. So group pipeline of beds with a blend of capacity expansion to existing facilities and mental health growth. We have seen good volume growth and also continued growth in our renal dialysis and oncology.

On international starting off with Poland, the focus in Poland will be to complete the integration of the acquired businesses and to drive efficiencies. We have seconded staff to Poland and in particular one of our managers with operational experience. Our M&A activity will be on hold until we have clarity around the pricing. And government has proposed further potential pricing changes. These price changes are currently being reviewed and impact is uncertain at this stage.

In India we will be focusing on adding beds, brownfields expansion, optimising the current network through improved occupancies, improvements in speciality and channel mix, improvement in cost structures, and then growing the pathology and oncology feeder centre lines of business. Before I hand back to Adam I just want to also mention that we have put out a cautionary this morning regarding a potential transaction. At this stage we are unable to provide further information on the transaction. And I will now hand over back to Adam. Thank you.

Adam Pyle
Thank you Andre. We are now available to take your questions. What we will do is we will take the questions on the call first and then we will take questions through the website.

Operator
Thank you very much gentlemen. At this time if you would like to ask a question you're welcome to press star then one. That will place you in the question queue. If you however decide to withdraw the question you're welcome to press star then two to remove yourself from the question queue. The first question comes from Kane Slutzkin of UBS.

Kane Slutzkin
Hi there guys. Just a couple of questions please. Just on your margins if you were to make the occupancies where they are do you anticipate some upside to margins given recent Rand strength, or

will that merely offset other cost pressures? And then just on your occupancies, obviously we had a material uplift in H2. Could you maybe just talk to that? Is that a sustainable number versus what you did for the full year? If I look at the PPD expectations for next year versus what you did this year maybe it is not. Maybe give us some colour on that occupancy in H2.

Andre Meyer
Hi Kane. Regarding our margins firstly there is a benefit with the Rand strengthening. And that will reduce some of the pressure on our cost of sales. And we will certainly try to improve our margin. There are some underlying costs which are coming through in salaries and overheads which will mitigate that improvement. So our forecast for our margins is that they remain the same. I suppose the margins that we talk about, I think the real number for the business is the 27.9% margin rather than the 27.5%. That is we think a more appropriate number in terms of the margin. We think they will remain fairly stable. In terms of our occupancies 74% occupancy in the second half is fairly… We had a stronger second half because of the winter. It is certainly pushing the top end of what we think is our full capacity for the group, hence adding the certain beds. But it is not that difference to what we see in previous years. It has slightly increased. That is just the nature of our [unclear] during the year. Have I answered your question, Kane?

Kane Slutzkin
I was just wondering whether H2 is a sustainable number or if it is more a full year number looking forward.

Andre Meyer
I think looking forward it is more the full year number.

Kane Slutzkin
Okay. Perfect. Thanks.

Operator
The next question comes from Sean Ungerer of Arqaam Capital.

Sean Ungerer
Good morning guys. In terms of Poland you obviously have quite a few measures you want to implement. Could you perhaps comment on what sort of measures were taken this year that would have stopped the margins going below what was reported? And then just on that maybe you could give a bit of insight on what you are expecting for margins for FY17. Obviously you have given clear guidance for SA, but Poland you just alluded to the fact that it's a turnaround story. And then just in terms of M&A I know you can't chat about the deal in the loom there, but can you maybe comment about funding structures going forward? I mean if you look at it historically with Poland and India it has been pretty dilutive. Should we expect looking forward the deal to be accretive? I think that's one of the key things. And then just lastly in terms of the scrip dividend option you alluded to the fact that some of that will be used to pay off pref shares. What has the take-up been on that in the past and do you expect that to increase? Thanks.

Andre Meyer
So the measures that we've taken, Sean, on the improvement in the margin in this year has really been after the appointment of the new CEO, Hubert Bojdo. And it really started off in around about August this year. So there is very little impact that you would have seen in terms of the initiatives that he has taken. But he has identified quite a number of initiatives where clearly the previous management team did not do the integration properly and where there is potential for us to drive further costs out the business. One of those will be the centralisation of support services. And then secondly also the

procurement, just centralising the procurement within the business. So we haven't seen any of this coming through in the 2016 financial year but we will see those coming through in the 2017 financial year. But obviously that will be offset by the tariff impact.

Sean Ungerer
Okay great. Thanks.

Andre Meyer
I will ask Pieter to give some input on what he believes the margin will be.

Pieter Van der Westhuizen
Kind of stable, Sean. The challenge with the margin is we had a tariff reduction so what we are doing at the moment is to go back to the suppliers. When I talk suppliers I specifically talk our biologists and negotiate with them on the prices that they charge through to us in terms of the contracts that they have with us as well as on a salary basis we also did that. And that is a market movement in Poland. So we would forecast a stable margin around 10% for the 12 months. And then just on the scrip firstly we had a take-up of around 20% in December of last year and another 40% take-up in June/July this year. In terms of our estimations we would like to believe it would be between the 20% and 40% take-up in this period. We will again utilise that to repay the expensive debt on the Polish and Indian acquisitions. In terms of how we look at funding the transaction we do have a healthy balance sheet still. We obviously don't want to put the balance sheet at risk or the company at risk in terms of funding acquisitions only through debt. We would look at the transaction to be cash earnings accretive going forward if we utilise more debt.

Sean Ungerer
Okay great. This is a follow-up. Just in terms of the Polish business is there any risk of further impairment? Obviously you do have a healthy balance sheet but is there any scope for further refinancing to bring that cost of funding down? And then just lastly the hurdle rate for deals going forward, could you comment about that please?

Pieter Van der Westhuizen
Okay. So in terms of Poland Andre did allude that there are further regulatory changes that have been communicated in the market. We do not know the extent of them. So potentially if it is at the same levels as the current regulatory changes then yes, there would be additional impairment coming through. But because of the uncertainty at the moment there is not a lot that we know that we can disclose in terms of that. And in terms of the refinancing of the expensive debt there is some scope that we are looking at at the moment to introduce some shorter term funding to reduce the interest cost. So there will be a slight decrease in terms of the margin that the bank will charge us. But it won't be extra expense. And then in terms of hurdle rates, how we look at hurdle rates, we typically target a real return of between 4% to 8% after taking into account our bank rate.

Sean Ungerer
Okay great. Thanks.

Operator
Thank you. The next question comes from Matthew Menezes of Citi.

Matthew Menezes
Hi again. The normalised EBITDA margin that you guided for, 27.9%, that only adjusts for the malpractice but it doesn't adjust for the Competition Commission and the retrenchment cost, right? Is

that correct? So if you strip those other two costs out it is more comparable and you continuing EBITDA margin sort of 28.2% odd. Is that fair?

Pieter Van der Westhuizen
Matthew, it strips out the Esidimeni contract effectively and then the retrenchment cost. So the retrenchment cost and Esidimeni are [unclear].

Matthew Menezes
Okay. So it strips out the Esidimeni issues and the contract but not Com Com?

Pieter Van der Westhuizen
That's right. Correct.

Matthew Menezes
Cool. Thanks.

Operator
Ladies and gentlemen, just a reminder, if you would like to ask a question you're welcome to press star then one. The next question comes from Mark Wadley of Visio Capital.

Mark Wadley
Good morning guys.

Andre Meyer
Hi Mark.

Mark Wadley
I've just got a couple of questions around India, maybe no surprise to you given that I've raised some of these points before. But I just want to quantify some of these things. The numbers that you presented for Max Healthcare today, those are the numbers that Max India presents for the whole Max Healthcare network. Is that correct?

Pieter Van der Westhuizen
That's correct, plus adjustments on our side.

Mark Wadley
Yes. So the adjustments are just date adjustments, right, because they have a March year end and you have September year end. So you add in the different quarters to get to the number that you're presenting today.

Pieter Van der Westhuizen
As far as [unclear] in accounting policies we have to adjust on our side for the difference in accounting policies. So there are additional charges on our side. We have actually disclosed on our website how we reconcile back to our numbers. You can have a look at that. I don't have it in front of me, but I'm happy to take you through that.

Mark Wadley
The numbers on your presentation today include the three hospital trusts that Max India has management contracts with, right?

Andre Meyer

That's right.

Mark Wadley
And it is also fair to say that those three trusts have higher EBITDA margins than the businesses that Max India actually owns.

Pieter Van der Westhuizen
No. They would be the same. There is no difference.

Mark Wadley
Not according to the disclosure in the pre-listing statement from Max India earlier this year. What I'm trying to get to is that the numbers presented today both in terms of revenue and EBITDA are for the Max Healthcare network which are entities that Max Healthcare and therefore Life Healthcare do not actually own. Is that correct?

Andre Meyer
Yes but we manage those facilities.

Mark Wadley
Yu manage those facilities. That's correct. And you collect a management fee for running those facilities. It is not the same as booking revenue and EBITDA.

Pieter
Yes but in terms of the accounting standards we get into control [unclear] legal framework of those trusts.

Mark Wadley
I understand that. But when you report your numbers and you bring in your associate income from Max Healthcare it doesn't include the revenue and EBITDA from these extra facilities?

Pieter Van der Westhuizen
No it only includes our management fee effectively.

Mark Wadley
That's correct. So these numbers are not quite the same as numbers that come into your associate income line.

Andre Meyer
No, they are.

Mark Wadley
Well there is a big reconciliation difference is what I'm trying to get to, and that's not clear from the presentation.

Andre Meyer
It is very difficult on a call to take you through it, Mark. If we can just make an appointment and go through it. We can put it on the website for you.

Mark Wadley

That would be very helpful. I won't take up any more questions on that right now, but I do believe these numbers are overstating the numbers that you then report into your associate income line. But if you have a reconciliation that would be very helpful.

Pieter Van der Westhuizen
Yes. I just want to state that these numbers have been audited by our auditors and they are also comfortable with these numbers, Mark. But we will take you through it and publish it.

Mark Wadley
Thank you.

Operator
Gentlemen, at this stage there are no further questions from the lines.

Adam Pyle
What we will do is we will now move on to questions that have come through online instead of on the phone. We will read them out and give you our answers. The first question is how you calculate the R5.3 billion value of our stake in Max.

Pieter Van der Westhuizen
In terms of how we look at it Max India, the listed entity listed in India, the share price is around 137 rupees per share. If you times that by the number of shares in issue it gives you a value. The share in the Max Healthcare business is about 30% of that total business and their share is 50%. So therefore you times it out and it comes to R5.3 billion.

Andre Meyer
And that R5.3 billion is based on the share price as at 30th September and the exchange rate as at 30th September. I think if you did it today based on the Max H1 results you would probably get to R5.6 billion. [Inaudible segment].

Adam Pyle
The next question was why was our PPD growth 4% higher than what we presented at the 11 months update and why have you dropped that to 2% to 3% next year?

Andre Meyer
I suppose if you look [unclear] we finished the year strongly with late August, early September numbers which pushed our PPD growth up. We are never quite sure what happens in September. Usually the September numbers normally drop historically which is why we forecast a slightly more [unclear] PPD. But this year we were surprised by the growth that came through in September. I suppose we are obviously cautious in terms of our growth next year. We have a South African market is low insured life growth. You have a strong [unclear]. Our complementary occupancies are hitting over the 80% mark. So we are a bit cautious in terms of the 2% to 3% range.

Adam Pyle
The next question is about our transaction in terms of whether we can talk about the geography. We don't really want to go anywhere in terms of… We put the cautionary out. We are not going to say anything on that in terms of it.

There is a question on are we going elsewhere in Eastern Europe. Poland is a fantastic country. Poland has a good macroeconomic market at the moment. We are not going to expand in Poland until we receive regulatory clarity in terms of our prices. Once we get that and we think the pricing is now going

to be consistent we do think the Polish market is an attractive market to expand in. But until that point we certainly won't be expanding further into Poland. Regarding Eastern Europe we have always said what we would do is look at Poland first before going into other parts of Eastern Europe.

The question is our complementary business has done well. What is our competitive advantage there? I think there are a couple of issues here in terms of how we structure the business. So we like to build acute rehabs and the mental health facilities on existing sites. So we drive efficiencies that way. [Inaudible segment]. We normally do this with the buy-in of psychiatrists etc. So we think the way we have structured the model allows us to drive revenues and drive our margins. In addition we believe that a standalone mental health unit in particular gives better clinical outcomes rather than treating mental health patients in the existing facilities. From our perspective you get better clinical outcomes, better returns. And that's our preferred model in terms of mental health and acute rehab.

Andre Meyer
We have seen good demand coming through for our services, especially the mental health services.

Adam Pyle
I think we have really covered the question about the margins in Poland. There is a question on how much revenue we generate from orthopaedic and neurology.

Pieter Van der Westhuizen
It's about 10% to 15%.

Adam Pyle
And we covered the question of the Max value. Thank you for some of the questions coming through on line. There is a question about whether the R370 million impairment in Scanmed is enough. I think we have dealt with that. We think it is enough but if there are further regulatory changes then it probably isn't enough. But we [inaudible segment] we are not quite sure where they are in the process and we have to wait and see how that plays out.

There is a question whether we would sell our Max Healthcare stake and use the funds to potentially fund the transaction we are working on or to reduce our SA balance sheet. We have spoken about our investment in Max Healthcare and our position. We see ourselves as a bit more as active shareholders in our role than [unclear] operational partners. But our views are stated that we think if we get out of Max Healthcare at this point we will be underselling ourselves. We think there is a lot more value in Max Healthcare and their performance in the las six months is particularly good. So at this stage we have no intentions of selling our stake in Max Healthcare.

Those are all the questions that have come through on line I think. Let me just check. There is another question on the call which we are happy to go to while we see if there are any more questions online.

Operator
There is a follow-up question from Sean Ungerer of Arqaam Capital.

Sean Ungerer
Thanks guys. Just in terms of Max you are obviously quite bullish on the longer term outlook there. You did mention that the EBITDA margins of phase one, 13.5%, are what are being targeted for phase two and phase three. Do you mind commenting on a time horizon for that?

Adam Pyle
Sorry, we broke up there a bit. Could you just repeat your question?

Sean Ungerer
Sure. You mentioned earlier that the EBITDA margin for phase one of Max Healthcare hospitals at 13.5% was the benchmark target for the rest of the hospitals. Obviously they had 6.9% and 7.1% respectively. What is your time horizon do you think to get those margins to expand to that level?

Adam Pyle
It's between 36 and 48 months, Sean. Your phase two hospitals consist of four hospitals. We currently have two of those hospitals running at 17.5% and you've got two that are [unclear]. And so the challenge is to get those two other hospitals up. One is making progress. Actually they have both made progress in the last six months. Those are the challenge. We have spoken before about the [unclear] hospital. It was loss making in Max Healthcare in the first six months of this year but it was no longer loss making in the second six months. But that is our challenge. And in terms of the phase three hospitals my guess is it will take about three years to get there. I think we guided for a 1% increase in our EBITDA margin per year for the next three years going forward. And it's a combination of adding capacity, growing the business as well as [unclear] the existing hospitals.

Andre Meyer
Sean, they are also doing well, the management team, in targeting costs and taking those out the business. For the current year they have targeted 40 crore and they are on target to make that number. So they are doing well.

Sean Ungerer
Okay great. Thanks.

Adam Pyle
And we just have another question on line.

Operator
We do have a follow-up question from Kane Slutzkin from UBS.

Kane Slutzkin
Hi guys. You are obviously quite confident on the mental health down in SA and obviously you are not going to comment on this acquisition talk. But is that a view you hold from the global perspective too in terms of confidence in that side of the business?

Adam Pyle
Yes and no, Kane. Your mental health is one of the fastest growing businesses worldwide. So there is good underlying growth in mental health on a worldwide basis. And it is something that we would look at expanding into. It would just be a different model to what we have here. We drive the efficiencies because we have it on the existing hospital site. We have to look quite carefully at what the assets are overseas and how we expand. But we have indicated in the past that we would look to expand into area as such as mental health. So we are looking at not just acute care but the complementary services in terms of our future expansion.

Kane Slutzkin
Okay. Thanks Adam.

Adam Pyle
While we are waiting for questions coming on the call just online another question in terms of the R5.3 billion stake in Max. What is the percentage of the Max listed entity that we put into Max Healthcare?

Within there are three entities. There is Max Healthcare, there is the insurance business and there is the Antara [?] business. At this stage we attribute 70% of the implied value of Max India to Max Healthcare. Again it could be probably a bit higher than 70% but that's the number we have in terms of getting to that R5.3 billion number.

There is a question coming in. Have we changed any of our practises in the last couple of years that alter the nature of the relationship with our doctors? And the answer would be no. we have a doctor shareholding model. That hasn't fundamentally changed. And we certainly haven't changed how we interact with our doctors over the last few years. Okay. I think that's all the questions we have online. There are no more questions on the phone coming through. We can start to wrap up. Thank you very much for the time you have taken to listen to our webcast. Thank you very much.

Operator
Thank you gentlemen. On behalf of Life Healthcare that concludes this morning's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT