EQUITY MANAGEMENT (SOUTH AFRICA)

EQUITY INSIGHTS

Mediclinic International: Facing Regulatory Headwinds

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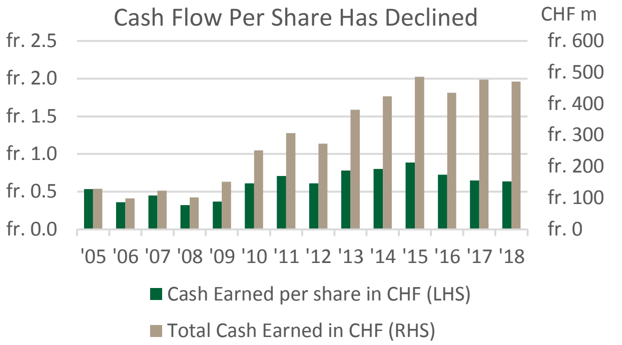
THE BUSINESS PAST AND PRESENT

Mediclinic ran a successful South African (32% of group revenue) and Swiss (45% of revenue) business in favorable environments for much of the past decade. High margins and strong cash generation were earned and the business re-invested most of that cash into growth and de-gearing post the FY'08 Hirslanden (Switzerland) acquisition.

Over the past few years, the group changed substantially, through the acquisition of Spire Healthcare in 2015, the merger with Al Noor in 2016 and acquisitions of additional Swiss hospitals, with notably more shares in issue today. Although the South African business continues to operate soundly, material operating and regulatory challenges were encountered in the Swiss, UAE and UK businesses.

	Mediclinic International
Market Cap	R 40bn
Current Share Price	R 54.25
52w High-Low Range	R 52 - R 120.2
Forward PE	10.5x
Forward DY	2.6%
Financial Year End	31 March 2018

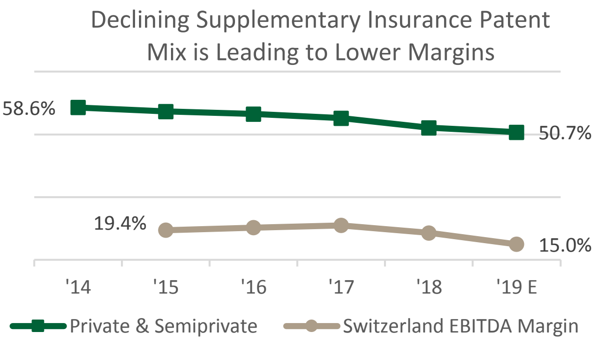
Sources: FactSet, January 2019



Sources: Company Filings & FactSet, January 2019

BUSINESS CHALLENGES

- Growth through share issuances and the Al Noor merger, has not translated into a per share benefit for shareholders in recent years.
- Approximately CHF 1 billion worth of impairments collectively from the Swiss, UAE and UK regions reported in FY'18 and FY'19.
- Swiss regulations have been introduced to structurally reduce healthcare costs. These include outpatient tariff reductions and a decline in supplementary insurance and hospital stays through pushing various procedures from 'inpatient' to 'outpatient'.
- The net result has been sharply reduced profitability, even prior to the regulations being fully implemented in CY'19.



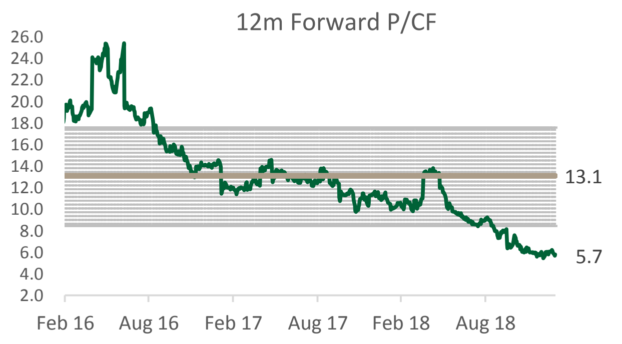
Sources: Company Filings & FactSet, January 2019

BUSINESS MODEL ADJUSTMENT

In response to the regulatory changes, the group is having to shift its Swiss business model away from highly profitable inpatient supplementary-insured clients, toward outpatient and basic-insured inpatient clients where profitability is not yet proven on aggregate. Revenue per bed and per patient is declining.

It has proven challenging to reduce the cost base of the Swiss business which includes medical staff, occupancy costs and debt servicing. Ongoing equipment investment and the associated depreciation costs are essential to maintain a high-end brand and attract the best doctors who in turn bring in the high-margin business. Operating activity is increasing amidst revenue pressure as the business grows low-margin outpatients and keeps beds occupied with less profitable basic-insured inpatients. Overall, operating margins are in decline.

Changes in regulation in the healthcare sector can substantially alter future cash flow expectations and the value of a business. Mediclinic has experienced this in Abu Dhabi with Al Noor and now in Switzerland. The potential for wide ranging reforms in South Africa to reduce the cost of healthcare also exists. The unstable regulatory environments in which the group operates has increased its risk profile.



Sources: FactSet, January 2019

CONCLUSION

Future prospects for the Swiss business and therefore for the group are now less clear as Mediclinic adapts to its changing environment. Risk is elevated at present with lower expected cash flow amidst high gearing in Switzerland, and ongoing regulatory headwinds.

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