

SA Hospitals – calling all doctors

Logic and the investment markets do not always go hand in hand. You would expect this to be a false statement. However, cast your mind back to the start of Covid. Based on logic you would have sold everything and bought hospital stocks such as MediClinic, Netcare, or Life Healthcare. Your reasoning would have been that hospitals would be in the eye of the storm, right? Unfortunately, Covid had the opposite effect due to patients been forced to “stay-away”, so you could not go for the knee-op. A large contributing factor to hospitals’ profit is elective surgeries and these are only now starting to positively impact revenues and profits.



**Willie
Pelsner**

Logic and stock markets do not always go hand in hand. This may sound very counterintuitive. However, cast your mind back to the start of Covid. Based on logic, you would have sold everything and bought hospital stocks such as MediClinic, Netcare, or Life Healthcare. Your reasoning would have been that hospitals would be in the eye of the storm, right? Unfortunately, you would have been

wrong for a while. There are perhaps many reasons but the most obvious is that a large contributing factor to hospitals’ profit is elective surgeries. It is here where Covid had its biggest impact on hospital groups. Due to Covid, doctor visits were rare, you could not see your specialist and had to postpone that operation.

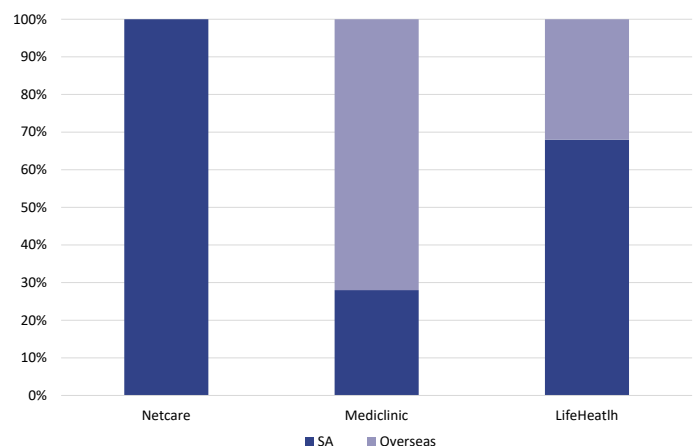
Over the past few weeks, all three listed hospital groups have reported results and all have shown incremental improvements in revenue and profits. We all have a sense that the Covid crisis is on the wane, and some healthcare analysts are recommending that it may be time to invest in these companies. Although we don’t differ from their views, this article is not a recommendation and/or confirmation that we are aggressively investing in this sector on behalf of clients. We just echo the sentiment. Collectively, the businesses are showing profit and turnover growth, but it’s been gradual and incremental. All three of the groups, MediClinic, Life Healthcare, and Netcare, are solid businesses. All are innovating in marvelous ways, and all are either expanding outside SA or have international coalitions. The chart alongside shows where the 3 hospital companies’ earnings are derived from. Netcare is now a 100% South African-focused company after they announced in March 2018 that they were exiting the UK market. MediClinic has operations

SPEED READ

- Considered at the time when Covid arrived, would hospital companies have been a preferred investment? The answer is not necessarily.
- The hospital sector (healthcare in general) is a defensive, consolidated, and resilient industry, but like health, it can sometimes be exposed to short-term term “illness”.
- Using MediClinic as an example, revenue growth and admissions for elective surgeries have started to move higher.

in Switzerland and the United Arab Emirates, whilst Life

GEOGRAPHIC SOURCE OF PROFITS



All hospital companies have diversified outside of SA over the years, with MediClinic being the most aggressive. On the other hand, Netcare has retreated back to its core home market after an unsuccessful attempt to conquer the UK.

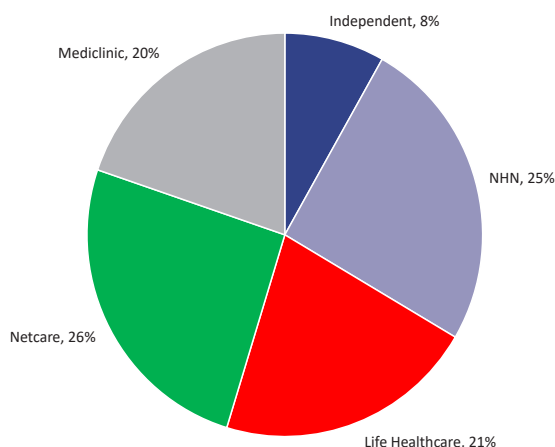
Healthcare has operations in the UK, Italy and Ireland.

On behalf of clients, we do have exposure to some of these companies and clients who own Remgro have an indirect exposure to MediClinic through Remgro's 44.6% stake in the company.

Why do we like this sector?

Firstly healthcare (hospitals in particular) is a defensive, consolidated, and resilient industry. Private hospitals provide high-quality healthcare to about 15% of our population - the resilient middle and upper-income groups who have medical insurance and who want to avoid being reliant on a weak state system. Furthermore, their revenue is derived almost entirely from insurance payments – as much as 90% - given the well brokered medical aid system. Secondly, the private sector dominates the hospital industry in this country. The three listed groups account for almost 70% of all private hospital beds in SA, making this a stable oligopoly.

PRIVATE HOSPITAL MARKET SHARE BY BEDS



SA's 3 major listed hospital companies own almost 70% of all private hospital beds in the country, making this a consolidated sector with high barriers to entry.

A few comments on MediClinic:

MediClinic has managed to navigate the pandemic fairly well across all three regions with operating profits returning to above pre-pandemic levels. The share price has recovered almost 20% since the start of 2022 driven by a recovery of inpatients as we mentioned earlier. The chart below from MediClinic's latest results presentation shows how non-covid admissions have recovered compared with the 2020 financial year.

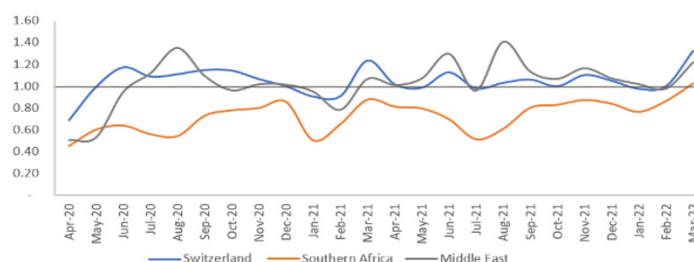
"Three listed groups account for almost 70% of all private hospital beds in SA"

Hirslanden, MediClinic's Swiss business, had a strong FY22 performance (6% growth in Swiss Francs), with revenue and margin beating both analyst expectations and the company's own guidance as the effects of COVID dropped away. However, there are pressures which should not be overlooked, including structural issues such as insurance down-

trading to cheaper plans, the switch to outpatient treatment, and potential cost pressures as a result of inflation.

MediClinic South Africa saw revenue growth of 18% and admissions also grew by 18% resulting in profit growth of more than 85%. Performance remained resilient and it continues to outperform its peers given that the SA business has recovered much faster than most would have expected. MediClinic is very well managed, understands the SA market well and benefits from a strong geographical footprint in the Western Cape.

INPATIENT NON-COVID ADMISSIONS



Finally after many months admissions not related to Covid are on the rise.

In the UAE revenues are now well above pre-Covid levels. The new Airport Road Hospital extensions and Cancer Centre continue to ramp up, which is resulting in rising occupancies for these facilities. Consequently, revenues grew by 9% and profit jumped by more than 30%. Demographics and lifestyle illnesses should continue to underpin volumes in the UAE.

Fortunately, margins are not overly high, which actually from a customer point of view, is something of a relief, although from an investor's perspective, we probably want more. Nonetheless, at the end of the day, the hospital sector is an important industry in SA, and one that has room to grow given the state of government facilities. But longer-term, growth for this industry depends ultimately on employment growth and the ability for more people to afford medical insurance. That will take longer to solve.



Topic: **Building an Investment Mindset**

Natal Midlands

Date:	9 June 2022
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	14 June 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am



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