Life Healthcare

Conference call transcript

9 December 2022

ANNUAL RESULTS

Mark Wadley

Good day, ladies and gentlemen, and welcome to Life Healthcare's audited group results for the 12 months ended 30 September 2022. All attendees will be in listen only mode. There will be an opportunity to ask questions when prompted. If you should need assistance during the call, please signal an operator by pressing * and then 0. Please note that this event is being recorded. I would now like to hand the conference over to the Group Chief Executive, Peter Wharton-Hood. Please go ahead, sir.

Peter Wharton-Hood

Thank you very much and welcome ladies and gentlemen to our annual results presentation. I'll kick it off by making an opening comment that we demonstrated strong underlying operating performance across all our markets. In our key metrics split across southern Africa, Alliance Medical, internationally and at group level, one can see that the key metrics have started to show green arrows, green shoots and a positive improvement at most levels of our company. Whilst this is a 12 month operating review, I urge you to pay attention to some of the statistics that are representative of what happened to underlying volumes in the second half of the year, which Adam and Mark will take you through a little bit later on.

You can see for the full year paid patient days were up by 5.8%. But I'll draw your attention later on to the fact that in the second half paid patient days were actually up by more than 9%. Theatre minutes up by 14.8% for the year, second half up 18.4%. Occupancy levels at 61.9% for the year, second half of the year sitting at just short of 65%. Revenue for the year up 5%, and EBITDA up 7.2%. Across our international business we see encouraging increases in underlying volumes, PET-CT up by 11%, the Italian operations up by 7.5%, Irish operations up by a commendable 24.4%, and revenues topping out at R7.7 billion for the year.

At a group level we exceeded R28 billion revenue for the year, normalised EBITDA at exactly R5 billion. And we're delighted to declare a final dividend of 25 cents. Our diversification strategy continues to work. Our international domestic split in revenue at 70/30 outside of South Africa, acute versus nonacute at 60, our normalised EBITDA at 70/30 and our acute versus nonacute EBITDA at 70/30. So, the direction of travel is along the lines of the plan that we articulated two years ago, which we will deliver by the end of 2026.

Underpinning our strategy and action, we can see that we've taken our ESG journey seriously. It's a group imperative. We've increased our renewable energy usage. We made progress towards environmental targets, and these will be linked to the performance of our executives. As far as targets are concerned, 2030 will get zero waste to landfill and 2050 zero emissions. We’re very cautious about our water usage. We've actively installed solar across our complexes and internationally we are electrifying our [unclear]. From a social perspective we

see this broken down into three key focus areas of community, education and healthcare. We believe this makes for a sustainable business.

We continue to deliver improvement in our diversity inclusion metrics. We see ourselves as being a force for good with targeted community support. Across healthcare we want to improve access. We have more than 20,000 pro bono cataract surgeries which we performed during the year. We have a screening partnership with Pink Drive. We’ve got bursaries and training for nurses and specialists in South Africa. We've helped improve access to clean drinking water and food relief partnerships with NGOs.

Our technology journey continues. What are we doing? We are modernising infrastructure, strengthening our cybersecurity, implementing our custom hospital information system, and introducing digital technology, data analytics and AI processes across the stack. What do we hope to achieve? We think that by modernising the infrastructure, we'll be able to exploit new technologies to the full advantage, both at the clinical and operating level. Our cyber function will protect the business and patient information as required. Our hospital information system has been a long term project to manage the commercial process or the process of the patient journey through our hospitals. And the introduction of advanced data analytics we see as us being able to leverage our data across the business for efficient resource utilisation at a very high level. That's the picture. I'll now hand you over to Adam to take you through our South African operations.

Adam Pyle

Thank you, Pete, and good morning, everyone. The Life Healthcare business in South Africa think experienced a very good year. And I'll provide an update on our acute hospital business, our complementary service lines of business, as well as our healthcare services division. And I'll finish off just covering the quality slide. So, you look at the slide. We started about a year coming out of the Delta wave, and we were soon into the Omicron wave in December. We also had to navigate a wave five in June and July this year. But what you can see from the graph on the right is the decreasing percentage of COVID PPDs, which we have compared to 2021. So, in 2021, between 19% and 24% of our total PPDs were COVID PPDs. That has dropped to just over 7% in H1 and then halved again to just 3.5% in H2.

This is reflective of both the lower number of COVID admissions we've had as well as the lower severity of these COVID admissions. The result of this is a normalisation of our underlying case mix. And what we saw over the full year is that our hospital admissions increased by nearly 16%. But what we experienced was a decrease in our length of stay of nearly 9%. We've also experienced a lower revenue per admission of nearly 10%. So, though that results in a lower increase at a revenue level, we do view this as a positive sign in the sense the businesses moving on from COVID-19 and our case mix is returning to what we experienced pre COVID-19. The bottom right hand graph shows the stronger H2 We experienced with admissions growing by nearly 21% over H2 2021. And the solid blue line you can see the decrease in the length of stay.

On the back of this increase in admissions, we look at both the acute and complementary businesses. We finished the year with a 62% occupancy, and we had a much stronger performance in H2. And the graph on the top right shows our occupancies are just over 65% for the second half. And Q4 occupancies were 66.5%. So again, a continued improvement. The bottom left graph shows the occupancy split between facilities. And you

can see the improvement in H2 2022, where the percentage of facilities, over 60% have improved dramatically. And we do expect this trend to continue going forward. The graph on the bottom right shows the improvement in both revenue and EBITDA margin from H2 over H1.

If we just look at the acute hospital business, we had a full year PPD growth of 5.4% and our theatre minutes grew by nearly 15% from prior, so a really good underlying performance. Then if you look at the second half, we had an even better performance with our PPDs growing at over 9% and our theatre minutes at just over 18%. And acute hospitals H2 occupancies are nearly 65%, which is good. For the full year our acute hospital revenue was 5.3% which was lower than one would normally expect with that underlying PPD growth, but again this is reflective of the change to a more normalised case mix. The graph on the top right shows the breakdown between this, and you can see the PPD growth, the tariff increase and the negative case mix change impact. One can see how this case mix change impact has reversed when you compare it to 2020 and 2021.

If you move on to the complementary services businesses, which had a really strong year, it is slightly different to the acute business in the sense that that the activity was fairly evenly spread across both halves. The PPDs for the mental health and acute rehab business grew by 9.4% for the full year and 12% for H2 verses H2 2021. This growth is reflected in occupancy percentage for H2 which is over 73%. Renal dialysis and oncology continue to show good underlying growth. And this resulted in a 15% full year revenue growth. And there you had 22% revenue growth in H2 versus prior year. There is less of a case mix impact in the complementary lines of business when you compare it to the acute business. And the revenue in H2 also benefited from the acquisition of the non-clinical operations of East Coast Radiology in February and Eugene Marais Radiology in August.

The Life Healthcare imaging business did approximately 19,000 MRI and CT scans and roughly 100,000 x-rays and other scans in 2022, which when you consider that in the prior this business was non-existent, a really good performance this year. The photo on this slide is the Varian Ethos radiotherapy machine at Life Vincent Pallotti. This machine is the first in South Africa, one of only 60 in the world. And it delivers a highly advanced, precise and personalised oncology treatment to patients. The purchase of the Ethos machine is an expression of our intention of growing our oncology business, but also improve the delivery of cancer treatment. This is one of a number of steps we've taken to grow our oncology business. As an example, at Life Vincent Pallotti we are also adding a new chemotherapy unit, as well as adding additional oncologist doctor rooms.

If we turn to our healthcare services division, and I'll start here with the Life Health Solutions business. So, in 2021, we mentioned the increased revenue and EBITDA Life Healthcare Solutions had received from the COVID screening and contract tracing, which we introduced during the COVID pandemic. This revenue and EBITDA started to normalise in the second half of 2021 and there was very little revenue in this regard in 2022. So, the occupational health and wellness business is a really competitive one. And so, this year, we've gone through a process in terms of reviewing our cost base, developing new products, new sales channels and developing systems. I'd say it's been somewhat of a reset year for the business. And we do expect a much better year in 2023.

Life Nkanyisa, which is the new brand for Life Esidimeni, meaning the bringer of light, is the largest healthcare PPP in South Africa with over 1 million PPDs. And to put that into context, Life Nkanyisa has just over 3,000 beds.

And the acute and complementary business has nearly 9,000 beds and they delivered 2 million PPDs. So, it goes to show you the volume of patients that we treat in Life Nkanyisa. It had a steady year, growing revenue in line with CPI. And despite some overhang from COVID-19 costs, they have managed this fairly well.

If you look at the segmental breakdown, the underlying activities result in a revenue growth of 5% with the acute and complementary businesses growing by 6% off the back of an overall 5.8% PPD growth, but at lower revenue due to the normalisation of the case mix I mentioned earlier. Normalised EBITDA grew by 7.2%. At an operational level normalised EBITDA grew by 15% with the acute and complementary businesses growing by 18.3%. In the acute and complementary businesses, we have been able to improve margins, increase underlying activity, improved operational leverage and improved efficiencies. We are now starting to see the benefits coming through from our increased investment in our integrated clinical products, increase investment in data analytics, IT and cyber. And these benefits will become clearer going forward. And just an example, we are launching our first integrated clinical approach in 2023.

Lastly, I'll finish on our quality slide. We had a good overall quality performance. And with this normalisation of our case mix in the second half, we can start comparing to our pre COVID-19 years. We also took the opportunity during COVID-19 to review what we measure from a quality perspective. And as part of our continuous drive to improve patient safety and clinical outcomes, and to increase the potential, identify trends, identify opportunities for improvement, we've made a number of changes in terms of what we measure and how we measure. And this is a good reflection in terms of how we look at our clinical outcomes as well as overall patient experience. Thank you. I will now hand over to Mark Chapman, our CEO of Alliance Medical.

Mark Chapman

Okay. Thank you, Adam. Good morning, everybody. Over the next few slides, I want to highlight how we're seeing the growth in diagnostics and indeed, how diagnostics is having an increased role in the patient pathway. So why diagnostics? We know we operate with an ageing population, and certainly an increased disease burden, which requires diagnostic investigations. We also know that earlier diagnostics translates into improved outcomes for patients, lower total cost of care and improved efficiency. However, we can still see the variation to the chart to the right for MRI, CT and PET-CT. In the markets that we operate we're still lagging a little bit behind some of our peers in Europe, and certainly in the US. And indeed, I think the Financial Times this morning highlights the spending in the UK, which includes some of that thinking.

So, we also know that the population based diagnostic programmes are starting to kick in. Indeed, we can see that in the UK with lung cancer screening programmes. I'm pleased to say that the team in the UK are now starting to implement some of these programmes across regions. Looking forward, the theranostics and the therapies and interventional radiology will provide further opportunities for the business. So, just to recap on our footprint as well, we are market leaders in our position where we operate, certainly in our three core regions of the UK, with market leading position in the imaging services, the PET-CT and radiopharmacy, which again is a unique vertically integrated proposition for molecular imaging. And in Ireland and Italy, that market leading position in the imaging services. Also in Germany, I think it's worth noting our network of cyclotrons is a leading position in Germany, which also provides a good distribution network across northern Europe. Certainly, when we start looking at the future, for our preparation for NeuraCeq manufacturing, we are in a good position.

So, if you look at the markets, just look at the UK, I think it's probably worth just going through to highlight the history of the growth. So, if you look at the average growth rates in CT, MRI, and PET-CT before COVID, and the comparison on the right post COVID. So, I think that highlights the resilience of diagnostics. We do expect that growth to continue. Certainly, when you look at the demographics, and what I was saying earlier about the ageing profiles and the disease burdens, I think that underlines our underlying performance this year in 2022 of a 10% revenue growth. And if you look at the markets in the UK, Italy and Ireland, all the health services are under stress. And we can see that with the NHS, the ASL in Italy in the HSE in Ireland. And we are supporting the services accordingly. And the waiting list in the UK, as an example, continues to grow over 7 million. So, we believe the opportunity is there.

I will now just go through a quick overview of the different territories, starting with the UK. The UK accounts for 55% of the revenue. What we have seen is the mix during COVID. The diagnostic imaging sort of overtook that mix of the molecular imaging, and you can see in 2022 H2, the molecular imaging, which is the PET-CT and the radiopharmacy, has moved to 55% of the revenues in the country. We also see the increasing number of scanners in two key areas, the PET-CT, which is no surprise when you start seeing the growth and the utilisation on those scanners, which you'll see shortly, requires additional PET-CT.

And also, the CT opportunity. I think everyone's aware of the CT COVID support during COVID for the NHS. Those facilities and mobiles are still in existence and are being utilised. And the chart to the right you can see this revenue mix. Yes, in 2021 you could see the increase of mobiles from a revenue mix supporting the COVID initiatives. But they are all trending in the growth. And you can see the growth in the PET-CT mobiles. It has been normalised now, but good utilisation. A bit more of a business as usual. Tariff and also diagnostics I'm pleased to see is coming back to pre-COVID and it's growing accordingly.

But just to unpack that a little bit more, if you look at the molecular imaging, where the picture in the top right is Sidcup, which is the first digital PET-CT scanner that we deployed into the UK with the NHS. You can see the growth with the molecular imaging over the last six years. Double digit at 11.8% is encouraging. And you can also see the utilisation in the top right chart, which has been driven by increasing the capacity on the existing base, but also, using the innovation of the digital PET-CTs where on an analogue you'd probably be doing around 15 to 20 scans per day and on the digital it’s circuit 30 with an ambition to grow that as well as that innovation matures.

So, in summary, looking forward, the PET-CT, we do see the continuation of this growth. There is an inflationary protection within the contract which I've explained in the past. We do see an additional growth in the medium term of 11 scanners to support the growth that we're seeing in this part of the business. And also, we need to make sure that the cyclotron capacity matches that growth through additional cyclotrons, but also, we've concluded a refurbishment of the programme and to make sure the cyclotron provision is fit for purpose over the next five to 10 years.

If I look at the diagnostic imaging part of the UK, I think it's worth mentioning that it was slightly inflated due to the COVID-19 support. However, the underlying growth is starting to come through very nicely. And that's

supported by the waiting lists and supporting the NHS. And I think the strategy of CDCs in the UK is important to note where there is a move to move diagnostics work in the acute services. And I'm pleased to say that the team now have seven CDCs operational. There's two under construction. And there's a healthy pipeline of conversations being had with the NHS in different regions and also different trusts. There is continuing pressure on the business from the inflationary pressures. But the team continued to work looking at the pricing strategy for the mobiles, and also working with the NHS on some of these new contracts to try and minimise some of that risk.

If I then move on to Italy, the Italian market represents 27% of the revenues. And again, you can see on the bottom left over the last six years there's been solid growth of 5% in volumes. You can see a slight change in the mix. And indeed, you can see the narrowing on the bottom right of the public and the private mix. And this is to my point earlier on where the government ASL budgets are being awarded locally to support the waiting lists. And this is a common picture that we're seeing across the market. The team in Italy also are looking at the pricing strategy for the private self-pay to help offset some of the pressures they are seeing certainly within the energy increases within that market. But maintaining the margin at the moment, and I foresee that to go forward for the year.

If we look at the Irish business, I think Pete just mentioned that represents 13% of the revenue. The growth coming out of Ireland is very encouraging at 17.4% average growth rates. What we are seeing again, a bit like Italy, is that mix change. And to the chart on the bottom right, you can actually see that the public services for scans is overtaking the private. And again, this is the HSE, the government looking to support the challenges that they have now in the post COVID world with increasing waiting lists. And I’m pleased to say that our teams are utilising that effectively and working with the government accordingly. And also, I think worth noting is that we are utilising the asset base. And you can see the utilisation in the chart to the top right, the number of scans per scanner.

I think on the next slide what I want to try and do here is just pull out a case study which supports our CDC strategy. And I think it's quite useful just to go back and look at our first significant CDC in the UK. Though remember, we do have CDCs in Italy. But for the UK strategy supporting the NHS strategy with the Mike Richards Report, think it's worth going through this again. So, this was Colchester, the Turner Diagnostic Centre. Paul Turner, the artist, was born there. You learn something new every day. But I'm pleased to say that this was a £12 million investment. The payback is just over six years. It is achieving the business case, and it's delivering high teens IRR. The service that we provide, it’s a very strong public private partnership within the local trust but also the local area of Colchester. And we service it with PET-CT. We have two MRI scanners. And indeed, on the first floor, the NHS has nuclear medicine facilities and provides SPECT imaging. We're working very closely together. I'm pleased to say that this is a great example of PPP, public private partnerships. And the NHS see this is an excellent reference site as well as ourselves.

So, you can see it is a significant investment. But it does provide us with a long term long term performance, but also long term returns which are very acceptable. And I think we've got the 15 year agreement. So, we are also now seeing that in the mobile is required because the two MRIs are at capacity. And this is now supporting conversations of do we increase another MRI scanner into the into this building, or indeed, will we look a second

CDC within that geography? All future overflow capacity up to those 15 years has got to be delivered by Alliance Medical. I think it's also worth noting that there's a 60 year lease as well. So, it's a long term investment with long term returns.

On the next slide, I think just with that in mind, I just wanted to go through the capital allocations. And we do expect, and looking at the previous slides, we will see the average growth rates in activity to continue. I wanted to have a look at our asset base as well, because you can see here that we've got circa 38% of our scanners over eight years old, and 33% under three years old. And you can start seeing that there's got to be an element of maintenance capex, but also the growth opportunities that will come through. And you've seen that in the last couple of years, certainly, as we've increased the CT and also looked at replacement of the MRIs during the COVID period.

If you look at our PET-CT, the average age of the PET-CT scanners, you can see that there's a rolling programme there. But the average age is around seven years, which is no surprise because that's in line with a contract for PET-CT in the UK. But like I just highlighted, I think the CDC strategy provides a very good opportunity for us to invest in long term returns, sometimes slightly lower margins because of the mix, but it’s solid returns. And where appropriate we will also include PET-CT within these provisions. So, the look forward for this year, we expect a circa £60 million investment into our maintenance, but also our growth opportunities going forward.

On the next slide, I think it's just a good opportunity to see the health of the business and also the returns of the free cash to support the growth opportunities. And you can see over the last four years, we've delivered 61% of the EBITDA as free cash. This provides us the opportunity to repay debt, but more importantly, also to make the investments in the growth opportunities. And the return on capital employed you can see in 2022 was 15.8%. It did dip in 2020 through COVID. But again, if we were to take an average, it is over the 15%. So, a good area to invest. And like I said earlier regarding CDCs, these are long term investments with growth opportunities that deliver long term returns. We will continue the strategy of CDC investment and also supporting the growth of the PET-CT and molecular imaging through increasing the PET-CT provision and ensuring that we've got a cyclotron network across Europe to maintain the delivery of isotopes for that growth.

Then finally, to ensure that we are a partner of choice with governments, but also our private customers, we need to deliver excellent clinical services. And I'm very pleased to say if you look at the targets and all the measures across the UK, Ireland and Italy, we’re ahead of target in every measure. And more pleasing if you look at some of the exceptional performance in the patients’ experience and friends and family, this is very encouraging. I’m pleased to say there's nothing significant or any concerns within our clinical quality. So, that concludes the international section and what I think you can see has been a very solid performance for the business. And I'll now pass you over to Pieter to go through the finances.

Pieter van der Westhuizen
Thank you, Mark. Adam and Mark have gone through the operational performance of the business. And although we have robust growth both in SA and in the international operations, there are a number of once off items in the current year and prior year that distorts the comparison of the results. One is the benefit of COVID contracts in the international business in last year, the disposal of Scanmed business in the last year results, and

then we raised in the current year a provision on a dispute with the tax authorities in South Africa on a VAT matter on an interpretation of a legal contract. And although there is no loss to the fiscus, we provided a provision of R200 million for that. And then following on from a news flow on disease modifying drugs and our expected delay of reimbursement for these disease modifying drugs, we released a contingent payment provision on that LMI transaction of around R400 million Rand.

Also pleasing to announce that we launched a corporate bond programme in the current financial year and issued our first bond of R1 billion in total towards the back end of a current financial year. The balance sheet remains strong with net debt to EBITDA below 2x as measured in terms of the bank covenant agreements, well below a covenant of 3.x. And it's been stated, we declared the final dividend of the year of 25 cents, bringing the total dividend for the year at 40 cents.

Now to unpack the revenue and try to explain what the underlying business performance contributed in terms of the revenue growth. On the SA side, the graph on the left hand side, you start with the 100% being last year. And you can see on the graph that the activity growth and the tariff change that came through contributed roughly about 9% on top of the 100%. But because of the mix change as explained by Adam, where the COVID cases come through at a higher revenue per patient day, and we're now seeing and more normalised environment, had a mix impact of negative 4%. So, the overall SA business grew at 105%. And similar on the international business. Actually, the international business had very good growth. If you add up all the dark blue bars, it’s about 9.8% growth in the underlying business. But compared to last year where the COVID contracts were included, that's got a negative 6%, bringing down the overall growth only 102.8%.

If one looks at the income statement, R28 billion of revenue growing 4.9% against last year. Included in the results we've got these once off items that I just spoke to earlier. And then your total attributable profit down 12.7% to R1.5 billion. On a segmental basis, if one looks at the segments the SA operations contributing a 5% growth against last year on that revenue, and a 15% growth at a normalised EBITDA level. Corporate costs have increased from R1 billion to close to R1.3 billion. There is roughly about R180 million of this that will be recurring going forward of this variance, and the balance will disappear. And it's largely related to the IT environment where they're going through a process of establishing a cloud environment, as well as implementing a network modernisation across our organisation. We are currently carrying duplicate costs and we do expect that these costs will disappear in the next 12 to 18 months.

Normalised EBITDA margin for overall for the group is at 17.9% against 18.8% in the prior year. The international business had the biggest impact due to the benefits of a COVID contracts. The growth initiatives contributing close to R500 million of revenue. And that's only related to clinical trials. And then we actually stated in the prior year's results and at the half year results, we have commenced our investment for success. At the EBITDA level, it was a R30 million loss. Earnings per share from continuing operations down 7.7% against last year due to the factors as discussed earlier, and normalised earnings per share down 12.2%. And at a similar level normalised earnings per share from continuing operations excluding amortisation due to the acquisition of Alliance Medical in 2016, there is a huge amortisation and effectively we see this as a cash earnings of 127 cents per share.

The balance sheet, as I stated, the balance sheet remains strong with net debt to EBITDA below 2x. We've got available undrawn facilities of R4.4 billion as at the end of September 2022. And we do expect to spend about R2.9 billion in capex in the next financial year. This is split about a R1.4 billion in Alliance Medical of which roughly about R800 million is related to maintenance capex and the balance is growth capex. In SA we're going to spend about R1.1 billion. And our IT investment in next year is about R250 million, and we're going to spend roughly about R140 million on our growth initiatives.

As Pete stated earlier, strong cash generation. We are above our target level of where we want to spend. Our working capital investment needs to be less than 5% of EBITDA. We've achieved in total 100%, slightly down against last year. That's largely due to the timing of some of our creditor payments in the current year, and that target will remain at about 95%. Included in the cash flow as well is the employee share schemes where in the current year, we invested R217 million with the introduction of a co-investment scheme with senior management. The intention is to drive performance and to retain the staff, but also then to make sure that the staff is aligned to shareholder interests. Growth capex for the year R700 million and investments includes the acquisition of a non-clinical businesses of EMR and ECR. As Adam explained, in total just north of R300 million.

Our debt levels, our weighted average cost of debt has increased in line with worldwide interest rates moving upwards. Weighted average is now about 3.5% but on a post-tax basis we've got hedges in place. The SA debt we've hedged circa about 50%. On a blended basis, the international date we've got a fixed interest rates at around 25% of the debt. The maturity profile, we have refinanced our international debt towards the back end of the current financial year. We've pushed out the repayment of the debt that's maturing in March of 2023. It's now only maturing in 2025. And as well as launching the corporate bond programme with a three year note of R500 million and five year note of R500 million. The inaugural bond was oversubscribed by 4.8x, and we are in the process of flattening the maturity profile from 2025 onwards. And then lastly, the board has considered the growth opportunities as well as the available cash, the uncertain economic environment, and approved a final cash dividend of 25 cents. And I hand you now over to Pete to take you through the growth strategy and the outlook.

Peter Wharton-Hood

Thank you, Pieter. In summing up the context of today's discussion, I think you can see that the second half of the year's performance certainly demonstrates that the underlying operating activities are starting to return to a post-pandemic norm, added to which we've got some strong structural tailwinds where the demand for our services will continue to increase. The story of life healthcare is about good cash generation. And one can see over the four year period depicted on the right hand side that over those four years 50% of the EBITDA that we recorded was generated as free cash after a little investment in working capital, the payment of our taxes and the necessary maintenance capex.

Maintenance capex in this business is particularly important. It sustains and differentiates us. It improves efficiencies. It improves our clinical outcomes, allows us to modernise our facilities and also comply with regulations. Growth capex, on the upper hand, together with acquisitions will drive our diversification. And you have to see these in the two respective boxes. Our capex projects are all evaluated against strong, strict internal IRR hurdle rates. And to the extent that we can, excess cash is returned to shareholders. So, you'll see that 34%

of the free cash flow generated during the course of the last four years has been returned to our non-controlling interests and to our shareholders.

When it comes to the outlook, one can see that our strategy of revenue diversification and our strategy of moving to a lesser dependency on acute is taking shape. We have an integrated model that depends on the skill sets that we have in Alliance Medical to be able to differentiate ourselves in our South African market. And the free cash flow is also available for South African business to be able to explore and expand internationally. We do represent a differentiated set of capabilities as an institution. We acknowledge that there's some inflationary headwinds, but we can see strong volume growth offshore and domestically to offset those challenges. Our robust cash generation will continue. Our disciplined capital allocation will continue. And our strict balance sheet management will ensure that we continue to remain resilient and well positioned to deliver sustainable returns.

When one thinks about sustainable growth in 2023 and beyond, we could see it in three buckets. Grow existing business, build new offerings, and be recognised as the partner of choice with governments. In growing our business, we can see organic volume growth. We will invest in renal and other value based care products brought into the market in the first quarter of next year. We'll expand our footprint in oncology. We'll continue with our imaging services strategy. We will deploy radiopharmacy at scale in South Africa. And we will deliver new products and expand our existing PPPs with government.

Internationally, we can also see organic volume growth particularly evident in the second half. We will strengthen our partnerships. We will continue to continue to explore new markets, and we will make selected acquisitions. Our zero cost call option on NeuraCeq continues to be a conversation which I think we've explored in significant detail over the 12 months. But the next quarter will manifest itself in use flow that will allow us to be more specific as to what we think the outcomes are likely to be. As an organisation, our growth opportunities continue to be underpinned by our never-ending care of our people, and our continuing investment in technology, data and analytics.

So, the current the current trend which we’ve spoken about supports increased activities and higher occupancies in South Africa. And we've seen growth in paid patient days of between 5% and 6% during the first quarter of 2023. Government's drive around the world to reduce diagnostic waiting lists is expected to continue to increase demand for Alliance Medical’s services. And there we are expecting a growth in total scans in the first half of 2023 of somewhere between 5% and 7%.

In the context of our exciting growth opportunities, the selected acquisitions of the non-clinical operations in imaging will continue. Our radiopharmacy establishment and the build out, there'll be more announcements in due course as to the how that progress is taking shape. Our expansion into integrated clinical products, which depends on our substantial investment in data and analytics, will also be announced during the course of next year. And in the context of expansion internationally, as Mark has said, we'll continue to invest in our additional CDC sites, expand our contracts with governments where possible, and selective acquisitions will be made in Italy.

So, we as an executive team recognised both the challenges that our staff had to go through during the full year, the excitement that's been generated by the return to post pandemic normal levels of operating activities in the second half. We believe we have an exciting platform for sustainable growth in 2023 and beyond. I'll hand you back to Judith and we will take questions. Thank you.

Operator
Thank you, sir. Ladies and gentlemen, we will now be conducting a question and answer session. For the benefit of the telephone line attendees, if you'd like to ask a question, please press * then 1 on your telephone keypad. For the benefit of the participants connected via the webcast, you're welcome to post your written questions in the question box provided on your screen. Sir, at this stage we have no questions from the online attendees. I will hand over for questions from the webcast.

Adam Pyle
Thank you, Judith. There are a number of questions. This is Adam here, by the way. I'll start with questions on the South African side. There's a number of questions regarding our occupancy levels, and what does it look like going forward, as well as does it translate into improved margins? So, I suppose we finished the year with a 62% occupancy. H2 was getting close to 66%. And we'd certainly expect that in 2023 our occupancies will be around these levels. So, we do see an improvement in our occupancies going forward. Whether we get back to a 69% or 70%, it is certainly our intention. And certainly, a number of levers that Pete spoke about which we are looking at utilising to increase occupancies further. It’s a tightly competitive market, but we certainly expect our occupancies to get back to the 66% to 67% level as a start.

How that translates into improved margins, I suppose that we would like to have a higher margin. But we did see an improvement in H2. If you compare it to H1, there was a fairly good move in our margins. It was hampered by the fact that the revenue line is lower because of the normalisation of the case mix, the decrease in revenue per admission, the impact of the healthcare services division, and also some of the head office costs which impacts our margins. So, going forward as we continue to grow occupancies, we expect to see further operational improvement coming through in the South African business. There was a question in terms of corporate cost and how much is temporary. I think, Peter, you addressed that in terms of your slide. Then, Mark, there were couple of questions in terms of PET-CT and scan volumes in AMG and how does that translate into the margins in your site.

Mark Chapman
Yeah, sure. Thanks Adam. If I take the PET-CT margin, the question was is it increasing year on year? And the answer is it is. Certainly, if you look at the margin growth between 2021 and 2022, that increased by 1.7%. And that was including additional investment in additional cyclotron capacity. So, we do see the growth coming through on the PET-CT. A question was also asked about the overall margins. I think the PET-CT element doesn't come out overall, which was just talked to. And I think we've got to be very mindful that the opportunities with CDCs are there. Like I said earlier, they are a long term investment, and some of those do come at lower margins, but they’ve grown EBITDA overall. And also, the reference to lung cancer screening programmes, the additional staffing and nursing required to provide that service. However, the absolute EBITDA growth comes through. So, we are seeing in diagnostic imaging, the growth, the volumes, but it is at a slightly lower margin

overall. I think it’s also worth noting that the cost pressures are real, certainly in the euro zone. And where we do have the facilities, we are reviewing the pricing. So, for the self-pay and the mobile business, which it's not tagged to a tariff, that sort of pricing strategy and review has taken place. Prices have increased from the beginning of the year and is an area that we'll continue to monitor over the coming months. Thank you.

Adam Pyle

Okay. Thank you, Mark. I'll come back to a couple of questions on SA regarding October and November trading. So, what we've seen is the continued performance of the business from Q4 onwards into October, November. So, we had a fairly quiet start to H1 last year. There’s been a good activity improvement and we expect that to continue going forward. So, October and November looks pretty similar to what we experienced in Q4 of 2022. A question about whether we would get back to 20% EBITDA margin. It's certainly our intention and certainly something that we are working on hard in the business. Mark mentioned the pressure on costs. If you look in SA, I think we are fairly experienced and good at managing our costs. And from our side, we'll continue to make sure that, if possible, we can improve our margins. Pete, there's a question about whether we would consider… Are we happy with the AMG business in the long term or would we consider exiting certain segments of it? So, can I hand it back to you, Pete?

Peter Wharton-Hood

Sure. I think in Mark’s case study, one can see that the return in Sterling by project for the CDCs is at attractive high teens return coming back to us in Sterling with payback periods of six and a half years. And we are pleased to allocate capital into such projects. So, I've been asked the question, would we ever sell an asset? For a Chief Executive to say we'd never say is irresponsible. I've also been asked, are we selling the asset? And at this juncture, we're not selling the asset. So, we continue to invest. We believe in the plan. We can see the growth outcomes coming from the strategy. We've built a significant barrier to entry by developing that footprint across the key geographies in which we operate. We are delighted to have the asset and we're delighted to operate it. So, the answer is I think absolutely abundantly clear. We as executives continue to manage the asset.

Adam Pyle

Okay. Thank you, Pete. There's a couple of questions regarding the inflationary environment. Before I coming to you, Mark, I’ll just talk about it. From SA we've been through some heightened inflation this year. I think we managed our costs well, and we expect to be able to do the same next year. I mean, we do have challenges. We have increased costs coming through from load shedding which really came through in Q4. I think in Q4, actually in H2 we spent R20 million more on diesel and petrol than we had in the prior year. So, it’s costly, but we do what we can to drive efficiencies in the business to mitigate some of those increased costs. I will hand over to Mark. Do you just want to touch a little in terms of your inflation challenge you have in your business, and then your ability to get increases coming through the revenue line in terms of tariffs on certain lines of business?

Mark Chapman

Yeah. So, I think people probably saw the headline yesterday where inflation in the UK is going to be 11%. And it's the highest in 41 years, What measures do we have within the business? I've just touched on certainly the self-pay market, where we've done a pricing review, and increased the prices from the beginning of the year. The tariff conversation, if you look at the UK as an example, which is set, I call it the NHS currency. And that's not

just the currency for ourselves operating in that market, but also an average NHS Trust, which is experiencing exactly the same pressures with increased utility costs, energy and staffing. There's no indications on the tariff yet, but there are conversations around the NHS supporting the cost of living crisis within the trusts. And we've seen some of those benefits coming through in the past. So, I think it's something that we've got to be very mindful of and close to, to make sure that we can maximise that opportunity.

But I do foresee with the inflationary pressures where they are, that the NHS and other governments will have to reflect that price accordingly to continue to deliver the service. So, like I said earlier, it's an area that we're very mindful of. If you look at October, post the pricing increase, we've seen revenues for the month increase, which has helped support some of the additional increases in utility costs almost net-net. So, it's an area that we've got to be very mindful on and keep close to. I think there's some questions about our margin expectation. I think for 2023, we are forecasting and trying to make sure that the margin stays static, even though we are experiencing very high inflation across most of the markets.

Adam Pyle

Thank you, Mark. And then there’s a question about whether the COVID costs are now out of the base. I wouldn't say completely, but we certainly really reduced our COVID costs over the period of this year. There's a small element there in terms of some increased costs around [unclear], but actually, most of those costs are now out of the base. At this stage, we don't see any other abnormal increase expected over the next 12 months outside of I suppose a heightened level of cost of diesel and petrol in terms of load shedding. There are just some questions here in terms of debt level levels.

Pieter van der Westhuizen

So, based on what we are forecasting from a cash requirement for growth capex and maintenance capex and operational performance, we do not expect that our gearing levels will substantially increase. Obviously, the interest cost will go slightly up as the interest rates go up. But as I said, we have hedged roughly on a blended basis about 30% of our overall debt. And therefore, the interest cost won’t significantly increase. But in terms of how we will look at funding from a debt perspective, we will do a combination of bank debt and potentially capital corporate bond market to diversify more of our debt into corporate bonds if need be.

Adam Pyle

Okay. Then there is just a question on the normalisation of our case mix and what impact that has potentially on our H1 2023 revenue. It’s an interesting question actually, because there's a little bit of COVID that was stuck in from H1 2022. So, there will be a little bit of an impact in terms of the revenue. But the decrease in our revenue per admission will become less pronounced as we go forward. So, we certainly don't see the impact that we had this year compared to 2021. It will be a much smaller impact. So, for 2023, I'd expect from a normalisation of case mix we won't have the same sort of extremes of a 16% increase in admissions and a minus 10% weakness in revenue per admission. So that decreased revenue will certainly hopefully fade away over the course of the year as the COVID PPDs drop off.

And the last question is, would you consider reduction of beds in SA? I mean, we always review our units in terms of their performance, how we can utilise the efficiencies, the hospitals and the beds in different ways, and

how we can group them. Again, we always have a review of our portfolio of assets. Beds in SA, that's up in terms whether we think we're the best operators for those beds. If we do, then we certainly wouldn't sell them. If we don't think so, that would certainly be one of the options we'll consider, along with changing how we use those beds in a different manner.

I think those are all the questions we will go through. If there are any others, we will certainly respond to those individuals in writing back. I'd like to thank everyone for their time and for attending this morning. From our side, thank you very much.

Peter Wharton-Hood
Cheers. Thank you.

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

END OF TRANSCRIPT