

## Mediclinic International

A triad of quality assets

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April 2012

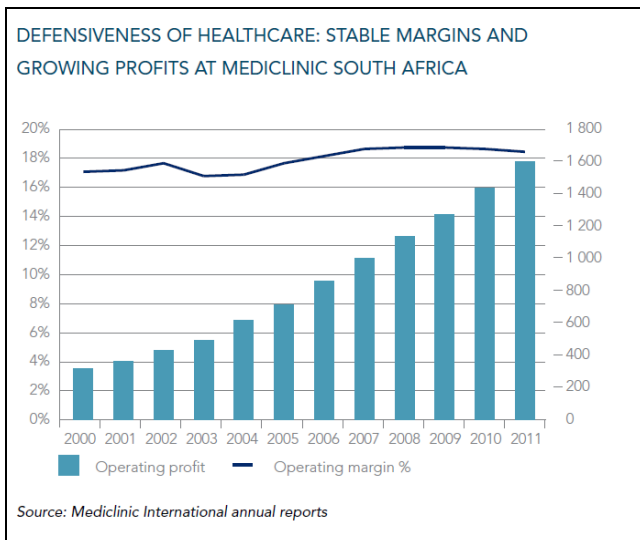
Mediclinic International is a business we have long admired for its stable management and world-class healthcare operations but have been constrained, for liquidity reasons, from owning a significant stake. Recently a line of shares became available which allowed us to increase our shareholding to a level that is more reflective of the attractive qualities of this defensive business with high barriers to entry.

Hospitals are long-term businesses that require significant investment over time. Mediclinic has established leading private healthcare businesses in southern Africa, Switzerland and Dubai by investing in hospital and medical technology infrastructure and recruiting doctors who are leaders in their specialist fields. However, this is not a business without risks. Healthcare will always be a politically sensitive, highly regulated industry and hospital businesses sit on captive assets. Risks can be mitigated by efficient, high-quality, cost-effective services and by charging prices that provide a fair level of return. We believe Mediclinic does just that, but we do provide for some risk adjustment in the rating used to derive our fair value for the group.

In valuing the business we look a few years out to fully capture the earnings growth we believe it should deliver and properly reflect the quality of its offshore assets. In our assessment all three regions are attractive; southern Africa should continue to deliver stable margins and steady profit growth, while the Swiss and Middle Eastern businesses should grow strongly. Based on a PE multiple of 11.7 on our assessment of normal earnings, this is an attractive price to pay for a good business that we see as a solid long-term investment opportunity.

Mediclinic has been involved in the provision of private healthcare to the South African population for over 20 years. It was formed in 1983 when Rembrandt (now Remgro) identified the need to establish a private hospital group in South Africa. While the southern Africa operation has remained focused it now forms less than 50% of our estimate of fair value. Diversification has been in the form of expansion into foreign markets, reducing the regulatory risks of operating in a single market and offering a good currency hedge. Operating across several regions has allowed Mediclinic to establish an international platform from which to offer high levels of specialist acute care and benchmark its clinical results accordingly.

The southern Africa business offers an extensive geographic network of hospitals. The strength of its locations and relative scale offer some power when negotiating with funders. In South Africa, private healthcare has remained the domain of the relatively privileged (8 million medical aid beneficiaries out of a population of 50 million), but we think there are opportunities to extend this reach. Growing membership of the Government Employees Medical Scheme and innovative low-cost networks from funders like Discovery have extended this market to a broader audience. Recent legislation to change medical aid contribution tax deductions to a system of credits will benefit lower income workers and could further grow this market. Mediclinic South Africa's stable margins provide testimony to the work done in managing costs, but we believe there are still areas for cost reduction, such as driving down doctor-determined costs like pharmaceuticals and consumables.



The private healthcare demands in Switzerland come from a wealthy, aging population who require superior quality service and care - for which they are prepared to pay. Mediclinic participates in this market through Hirslanden, the largest private hospital group with a national footprint in Switzerland. While the underlying market grows slowly, Hirslanden has shown superior growth. Its strategy has been to recruit specialist doctors and invest in facilities and technologies to create centres of expertise in which cross-disciplines of specialists work together to offer the highest level of care.

The recently introduced tariff system in Switzerland relating to the treatment of public patients will undoubtedly pose some challenges. However, we believe Hirslanden's network of specialised, efficient hospitals should provide sufficient protection from the more commoditised areas of care offered by many hospitals. The increasing regulatory burden may also drive consolidation in the market.

Hirslanden is highly leveraged and Mediclinic faces some risk from refinancing the debt in 2014. While this was a large transaction, we believe that at a group level Mediclinic International is in a good position to support the debt. The strong South African balance sheet could comfortably be leveraged further, allowing it to inject the required capital into the Swiss business. The group is also sitting on cash of CHF200 million in an offshore account that could be used to bolster the financial position in Switzerland. This was raised via a previous rights issue and is currently generating almost no return. The strong operating performance of the Swiss business and the secure nature of the portfolio should make the Swiss debt attractive to a number of banks. We factor in some increase in funding costs but think refinancing should proceed smoothly.

Over the next few years, the Swiss business will benefit from the investment in its facilities and experience strong financial deleveraging. This stable, but growing, Swiss earnings stream is supported by the underlying property portfolio.

Emirates Healthcare, the smaller part of the business in terms of valuation, has been growing strongly as it brings quality healthcare services to the Dubai market. This has helped to grow the market as residents who previously travelled elsewhere to access medical treatment are now seeking care locally. The recent acquisition of three clinics should also help drive referrals through its hospitals. Although competition has been increasing in the form of a small number of new hospitals in Dubai, to-date these have had no impact on the business. While management continue to build a strong local business, they are also creating a base that could be used to expand within the broader Middle Eastern region.

The three regional businesses generate scale for the Mediclinic International platform but more importantly provide an opportunity to share expertise across the group, be they cost savings or processes to ensure delivery of the highest levels of clinical care. Furthermore, the recent experience with the Swiss regulator has provided the group with learnings that could be applied in creating a more affordable, sustainable healthcare system in South Africa or broadening access in the UAE (United Arab Emirates). It is insights such as these that should help Mediclinic International grow its reputation as a quality provider of cost-effective acute care in international markets.



*SARAH-JANE ALEXANDER joined the Coronation investment team in 2008 as an equity analyst. Her current responsibilities include co-managing the Coronation Industrial Fund as well as researching food producers and hospital stocks amongst others.*

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