

Peter

Peter Nelson Chief Financial Officer

Netcare's results for the year are evidence of management's commitment to building a business for long-term sustainable growth. The year was characterised by a strong performance of the South African business, significant corporate activity and a restructuring of the balance sheet.



13,12%
cash flow
return on
investment
(CFROI®) for
South Africa
(2005: 13,05%)

This review provides further insight into the financial position, performance and recent major developments of Netcare, and should be read in conjunction with the annual financial statements presented on pages 103 to 168.

Corporate activity

A large number of corporate transactions were concluded during the year under review. These included the:

- acquisitions of General Healthcare Group (“GHG”) and Prime Cure;
- unwinding of the Netpartner crossholding;
- issue of perpetual preference shares; and
- the sale of non-core assets and investments to reduce debt.

The profitability of all operations was in line with our expectations and capital expenditure in the South African-based operations was at all time high levels reflecting Netcare’s belief in, and support for, the growth of the home base. These expenditures include the capital work in progress relating to the building of new hospitals at Tableview (R99 million) and Ballito (R43 million), the purchase of the Umhlanga hospital (previously leased) for R234 million and significant investments in medical equipment R185 million and IT (SAP) infrastructure R89 million.

Acquisition of a controlling stake in GHG

On 25 April 2006 Netcare announced that it had led a consortium to acquire a controlling interest in GHG, the leading private hospital operator in the United Kingdom. The acquisition was concluded on 12 May 2006 with Netcare acquiring an effective holding of 52,6%. As management of GHG take up their allotted equity this holding is expected to decline to 50,1%.

The UK healthcare market offers attractive growth opportunities as public funded healthcare is increasingly being privatised. This together with medical technology advances and aging populations across Europe and England, is expected to drive increased healthcare utilisation. The percentage of private acute and psychiatric care beds

(approximately 15 675) in the United Kingdom as a percentage of total acute and psychiatric beds (approximately 198 000) is one of the lowest world wide at just under 8%.

Netcare acquired its shareholding through a consortium with three leading UK-based financial and property investors, namely Apax Partners Worldwide LLP, London and Regional Properties Limited and Brockton Capital LLP. The Consortium acquired 100% of GHG for a total consideration of £1 310 million. It also assumed liability for debt in GHG amounting to £735 million and incurred acquisition related costs of £32 million.

For purposes of acquisition accounting in terms of IFRS 3 (Business Combinations), assets and liabilities were fairly valued at 12 May 2006 (the acquisition date). The property, plant and equipment constituted the main assets and were valued for accounting purposes at £1 632 million and made up as follows:

- £362 million relates to land which is not depreciated;
- £111 million relates to short life assets which will be depreciated over a period between 2 to 10 years;
- £1 052 million relates to long life assets which will be depreciated over 50 to 75 years; and
- £107 million relates to equipment and other assets.

Having regard for the above and the fair value of liabilities and provisions, the goodwill arising on acquisition was £1,120 million. Management have completed the annual goodwill impairment review and confirmed that the value is supportable.

Netcare’s investment in GHG comprised an equity contribution of £219 million as well as the injection into GHG of Netcare UK valued at £20 million. Financing for the equity contribution was raised through offshore loans and secured by Netcare. The balance of the purchase consideration was settled by the consortium partners and the raising of additional debt financing in GHG.

The debt of GHG at acquisition consisted mainly of £646 million in publicly listed bonds (Irish Stock Exchange). In terms of pre-agreed arrangements with the acquisition debt financiers, these bonds were cancelled and repaid on 17 July 2006. Early settlement penalties ("Spens") and associated costs of £77,3 million were incurred and were accounted for as a fair value liability within the acquisition balance sheet and form part of goodwill.

In September 2006, the process of transferring the properties of GHG to a series of specialised property holding companies was finalised with the result that GHG now consists of a clearly defined operational entity ("Opco") and a series of property holding companies ("Propcos"). All legalities with regard to these structures were finalised by year end. Following the year end, the debt financing was replaced with long-term Propco debt of £1 650 million and Opco debt of £215 million in October 2006. Notably the total debt of GHG is secured by GHG and debt financiers have no recourse to Netcare South Africa. Propco debt is secured over the GHG property portfolio.

Elimination of crossholding with Netpartner

In March 2006 Netcare proposed a scheme of arrangement between Netpartner and Netpartner shareholders to effect the unwind of their respective cross shareholding and for Netcare to acquire 100% of Netpartner. Accordingly, Netcare issued 77,7 million new Netcare shares to Netpartner shareholders in return for their shares in Netpartner, thus making Netpartner a wholly owned subsidiary of Netcare. The proposal was supported by all shareholder bodies, sanctioned by the High Court and became effective on 26 September 2006.

The result of the above transaction is that the 340,4 million shares in Netcare previously held by Netpartner are now treasury shares and that Netcare now owns 100% of Medicross (previously 20% held by Netpartner). The unwind also simplifies the accounting and reporting structures and improves transparency. Negative goodwill of R819 million has been reflected directly in equity, as the transaction related to the repurchase of Netcare shares. The transaction is 9% earnings accretive on a like-for-like basis.

Acquisition of a controlling stake in Prime Cure

In February 2006, Medicross acquired 100% of Prime Cure Holdings, an integrated South African healthcare services business primarily serving the emerging market for a total consideration (including transaction costs) of R125,0 million. Prime Cure has a network of 37 centres and approximately 2 400 contracted service providers and complements Netcare's footprint in primary care.

Risk management

Netcare is exposed to a number of external risks which could significantly impact on results. These risks are monitored on an ongoing basis and, where possible and in line with our strategy, appropriate derivative instruments are entered into to mitigate risk. Netcare does not enter into speculative trading positions.

During 2006, a web-based risk management application was rolled out at each significant business unit. These risks are monitored by operational and executive management on a regular basis and the major risks are reviewed by the Group Risk Committee on a bi-annual basis. In addition, the internal audit department includes these risks in its internal reviews and audit monitoring.

Major risks

Financial risks to which the Group is exposed can be classified into the following major categories:

Credit risk

Credit risk arises from customer non-performance or default. Considerable resources, expertise and controls are in place to ensure efficient and effective management of credit risk. Our credit risk arises predominantly from settlement risk which stems from transactions involving the non-simultaneous exchange of values where the Group honours its obligations to deliver value, and the counterparty does not. Currently the major area of concern relates to amounts due from the Road Accident Fund of R77 million, where the Company experiences delays in excess of 180 days in receipt of payment. This situation is monitored closely and adequate provisions are held. The Group also experiences concentration risk in that a significant proportion of the accounts receivable relate to one party. We believe that we are exposed to concentration risk in respect of both the Road Accident Fund and the Compensation for Occupational Injuries and Diseases (“COID”) of where the balance due at year end was R127 million.

Liquidity risk

Liquidity risk arises should the Group have insufficient funds or marketable assets available to fulfil its future cash flow obligations. The Group’s liquidity risk management framework is designed to identify, measure and manage liquidity risk such that sufficient liquid resources are always available to fund operations and commitments. To this end, a domestic note programme with an authorised value of R2 500 million was concluded during the year (see debt profile below). In addition, convertible bonds due 2011 to the value of R1,7 billion were raised after year end. These bonds are convertible at the option of the bondholder into Netcare shares at a price of R15,30 per Netcare share at any time from 22 November 2006

to 30 September 2011. The conversion price represents a premium of 25,4% over the prevailing Netcare share price at the date of issuing of the bonds. The bonds carry a fixed coupon of 6% payable semi-annually in arrears.

Operational risk

Operational risk arises from inadequate or failed internal processes and controls. Operational risk is inherent in all areas of our business. The strategic focus is on preventing, detecting, investigating and whistle blowing on fraudulent activities. The Group’s internal audit activities adopt a risk based approach and aim to audit all business units at least every three years and areas of greater risk more frequently. The Group maintains a zero-tolerance approach towards fraud and dishonesty.

Disappointingly, payroll fraud was identified in May 2006 and confirmed by internal and external forensic auditors. The fraud took place over an eight-year period and amounted to over R28 million. The employee in question has appeared in court and has been found guilty of fraud. There was minimal impact on the 2006 earnings.

Interest rate cash flow risk

Interest rate cash flow risk arises from movements in market rates relative to the agreed lending rates on contractual debt instruments. The Group enters into derivative interest rate swap instruments in order to mitigate this risk and applies hedge accounting where the effectiveness criteria can be met.

In the United Kingdom, the indebtedness of GHG has been converted to fixed rates through long term floating-to-fixed interest rate swaps covering a notional amount of £1,650 million relating to property mortgage loan finance, with a further £200 million relating to operating company debt.

In South Africa, swaps were entered into to cover interest on the equity investment of £219 million made by Netcare to acquire GHG.

This hedging position will be unwound as the debt is repaid. In addition, local interest rate swaps have also been entered into on a funds pool approach as the Group seeks to fix between 50% and 75% of local debt at any given time. The convertible bonds of R1,7 billion issued after year end carries a fixed coupon rate for five years and is an integral part of the above policy.

Exchange rate risk

Exchange rate risk arises from adverse movements in the exchange rate with reference to major currencies.

The United Kingdom debt of GHG provides a natural hedge against the assets of that subsidiary and, in addition, Netcare has hedged the foreign currency exposure with regard to its £219 million equity investment at a rate of R12,17: £1. This position will be unwound as and when Netcare settles its indebtedness.

The South African operations have limited trading with foreign markets, and are not particularly susceptible to either an appreciation or depreciation of the rand. South African based capital expenditure is rarely, if ever, denominated in foreign currency.

Operating results

Netcare (South Africa)

Due to the acquisition of GHG on 12 May 2006, the operations of the Group are not comparable on a year-on-year basis. The operating results set out hereunder accordingly exclude the results of GHG and Netcare UK, which are set out separately within this review.

Comparisons between the 2005 and 2006 financial years reflect strong organic growth and further improved operational efficiencies.

The key financial performance indicators for the year ended 30 September 2006 are as follows:

	2006	2005	%
	Rm	Rm	change
Revenue	8 184	7 353	11,3
EBITDA	1 617	1 438	12,4
Operating profit	1 350	1 194	13,1
Net finance costs	163	127	28,3
Earnings attributable to ordinary shareholders	960	800	20,0
Contribution to basic headline earnings (cents)	61	59	3,4
Shareholders' funds	1 995	3 418	(41,6)
Net debt	5 444	1 109	390,9
Net debt: equity (%)	273	32	

Revenue increased by 11,3% to R8 184 million (2005: R7 353 million), with increased admissions of 5,3%. All core divisions reflected positive growth. EBITDA grew from R1 438 million to R1 617 million with all operational divisions again reflecting solid growth.

EBITDA margins improved from 19,6% to 19,8%, while EBIT margins improved from 16,2% to 16,5%. EBITDA includes the following abnormal items:

- R85 million release to income of the deferred lease provision relating to the Umhlanga Hospital which was purchased during the year;
- R65 million relating to the IFRS 2 (Share-based payments) cost of the Health Partners for Life (BEE) trust; and
- R38 million of impairment costs relating to certain properties, intangible assets, goodwill and investments.

The Debt : EBITDA ratio has increased from 77% to 337% reflecting the higher level of debt following the acquisition of Netpartner and GHG. The Net Debt : Equity ratio has similarly increased from 32% to 273% for the same reason, but is compounded by the fact that the Netcare shares held by Netpartner are now accounted for as treasury shares. The R650 million worth of perpetual preference shares issued are regarded as equity by virtue of the fact that they are non-convertible, non-redeemable and non-cumulative.

South African net financing costs increased to R163 million (2005: R127 million) due to interest incurred on the financing of the investment in GHG, expensing of interest rate hedges and ongoing capital expenditure. Local net interest cover remains at a satisfactory 5.7 times (2005: 9.6 times).

Earnings from associates have decreased substantially due to the significant once-off restructuring costs expensed by Netpartner relating to the unwind on respective Netcare and Netpartner crossholdings. Earnings from associates will in future be primarily driven by Netcare's participation in Healthshare Health Solutions and Community Hospital Group.

South African property, plant and equipment increased from R3 134 million to R3 601 million due to ongoing capital expenditure in the Group (refer to cash flow note below). South African net asset value per share is R1,69 (2005: R2,36). If the properties are included at their market value, of R4 998 million (2005: R4 675 million) the South African net asset value per share at 30 September 2006 increases to R3,40 (2005: R3,94). Group net asset value per share is R1,89 (R4,16 if South African properties are included at their revalued amounts).

GHG (United Kingdom)

The key financial performance indicators for the year ended 30 September 2006 are as follows:

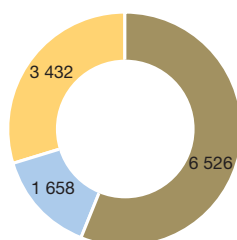
	2006 ¹ Rm	2005 ² Rm	2006 ¹ £m	2005 ² £m
Revenue	3 432	181	263,1	16,1
EBITDA	505	23	38,7	2,1
Operating profit	218	16	16,7	1,4
Net finance costs	679	3	52,2	0,2
(Losses)/profits attributable to ordinary shareholders	(231)	18	(17,7)	1,6
Contribution to basic headline earnings (cents)	(5)		(0,4)	
Shareholders' funds	4 241	23	292,0	2,1
Net debt	25 724	4	1 770,9	0,4

¹ Includes the results of GHG for the period 12 May 2006 to 30 September 2006

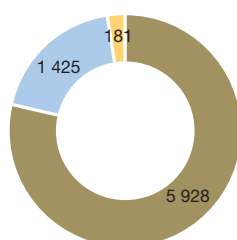
² Netcare UK only

Revenue contribution
(Rm)

2006



2005



- Hospital and trauma
- Ancillary healthcare and corporate office
- United Kingdom

The results from the UK business include GHG for the period from 12 May 2006 to 30 September 2006 and Netcare UK for the full year. Revenue from the UK business was R3 432 million and operating profit was R218 million for the year. It should be noted that the months under review are not traditionally the best months from a seasonal perspective, as elective surgery is usually lower over the summer months. Operating profit and EBITDA were negatively impacted by the following items:

- R280 million legal costs and stamp duties relating to the once-off restructuring of GHG; and
- R39 million (2005: R12 million) NHS bid costs.

The operating profit margin adjusted for these costs is 15,7%, whilst the EBITDA margin is 24,0%. Net finance costs arising primarily from the Opco and Propco debt amounted to R748 million. The impact of the GHG acquisition on the Group resulted in a dilution in headline earnings per share of 5,0 cents.

Exchange rates

	2006	2005
	R:£	R:£
For the year ended 30 September		
Closing rate at 30 September	14,53	11,42
Exchange rate at 12 May 2006 (GHG acquisition date)	11,73	
Average exchange rate (12 May 2006 – 30 September 2006)	13,04	

Group results

Income statement

Earnings attributable to ordinary shareholders decreased by 10,4% to R729 million (2005: R814 million).

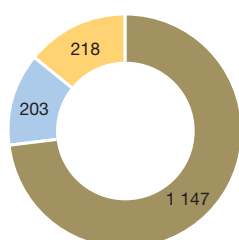
Net financing costs amount to R842 which incorporates the higher level of interest following the acquisition of GHG.

A number of capital items were accounted for during the year which impacted on headline earnings per share. Impairments of investments, loans, goodwill and property amounted to R37 million. Included in capital restructuring costs of R172 million were costs directly related to the acquisition of GHG of R161 million. Net capital profit on the sale of investments and subsidiaries includes realised profit on the sale of Netcare UK of R111 million.

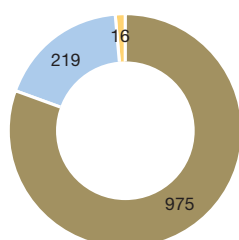
Headline earnings per share before taking into account the effect of the BEE transaction remained relatively flat at 60,7 cents per share (2005: 60,2 cents per share). Return on ordinary shareholders' equity ("ROE") of 29,2%, is ahead of last year's figure of 28,3%.

Operating profit (Rm)

2006



2005



- Hospital and trauma
- Ancillary healthcare and corporate office
- United Kingdom

Balance sheet

The Group's capital structure as at 30 September is as follows:

	2006 Rm	2005 Rm
Total equity	6 236	3 418
Total liabilities	44 265	2 864
	50 501	6 282

Debt profile

The Group's operations are funded primarily from operating cash flow. Any shortfalls are usually short term and are funded from banking facilities.

A domestic note programme with authorised facilities of up to R2 500 million was initiated during the year. In terms of this programme, commercial paper to the value of R1,550 million was raised at rates between JIBAR plus 0,35% and a fixed rate of 7,97% on the two-year paper. The proceeds were used to replace more expensive debt, as well as to fund ongoing capital expenditure on both new projects and within our existing hospitals.

During the year additional unsecured finance to the value of R207 million was raised to fund the purchase of the Umhlanga Hospital (previously leasehold). All other forms of asset-based finance were repaid from the proceeds of the domestic note programme noted above.

As a result of the elimination of the cross holding between Netcare and Netpartner (which was

previously equity accounted), debt previously accounted for within Netpartner to the value of R1 457 million was fully consolidated into the Group.

As a result of the revaluation of fixed property within GHG amounting to £1,15 billion (R16,7 billion), a deferred tax liability of £345 million (R5,0 billion) was raised. This will be released to income over the useful lives of the properties (50 to 75 years) as the assets are used in the production of income. An amount of £7,1 million (R9,3 million) was released to income since acquisition.

Equity profile

Perpetual preference shares to the value of R650 million were issued during the year. The shares pay a dividend of 75% of the prevailing prime interest rate. Perpetual shares were selected as a capital financing option as they provide additional flexibility with regard to capital availability and can result in increased returns for ordinary shareholders as a result of the added leverage.

Our net debt comprises the following:

	2006 Rm	Less: Non recourse debt within GHG	Debt with recourse to Netcare	2005 Rm
Long-term debt	29 224	26 464	2 760	493
Short-term debt	2 953	96	2 857	913
Total debt	32 177	26 560	5 617	1 406
Less: Cash	(1 009)	(836)	(173)	(293)
Net debt	31 168	25 724	5 444	1 113

The elimination of the Netpartner crossholding resulted in a fresh issue of 77,7 million shares, while 116,1 million shares were de-listed and revert to authorised. A further 340,4 million Netcare shares previously held by Netpartner were also acquired and are now treated as treasury shares as part of the consolidation of Netpartner.

An additional five million shares were also repurchased during the year.

Cash flow

Cash generated from operating activities remains strong at R2 129 million (2005: R1 608 million) reflecting strong cash flows from all operations as well as better utilisation of working capital. This is particularly pleasing given the higher net finance costs for the year.

Material cash outflows during the period include: investment in the Group's capital expenditure programme amounting to R1 014 million (2005: R469 million); share buybacks of R683 million (2005: R32 million) and capital distributions of R391 million (2005: R308 million). Major capital expenditure items comprise loans to various business associates and ongoing capital maintenance expenditure at the hospitals. Significant capital expenditure included amounts spent on the construction of new facilities in Tableview and Ballito, the acquisition of the Umhlanga Hospital (previously leasehold), as well as further investment in our SAP implementation project. The ongoing investments reflect Netcare's commitment to delivering high quality healthcare to its patients through continued investments in healthcare technology and hospital infrastructure.

Cash flow return on investment ("CFROI")

The Group continues to monitor performance, and evaluate potential investments using the Holt method of CFROI[®] as the dominant measure. The market derived cost of capital (minimum hurdle) in South Africa has increased from 7,2% to 7,5% during the year. Our South African CFROI[®] of 13,12% represents a 0,5% improvement over that achieved in 2005 of 13,05%. We expect this to improve in coming years as the benefits from capital investments begin to bear results. A group CFROI[®] has not been included due to the reporting period for GHG being less than 12 months. CFROI[®] is a registered trademark in the United States of Credit Suisse First Boston or its subsidiaries or affiliates.

Change in estimate – Property, plant and equipment

IAS 16 – Property, plant and equipment, requires the residual value and remaining useful life of assets to be re-assessed at each balance sheet date. Netcare had previously adopted a policy of only assessing the life and residual value on initial recognition. The effect of this change in methodology in determining the annual depreciation charge was to reduce the depreciation on South African property by approximately 35% (after taking additions into account) from R36 million to R28 million. The effect of this change on South African plant and equipment is immaterial.

Accounting policies

In line with the listing requirements of the JSE Limited the Netcare Group adopted International Financial Reporting Standards (“IFRS”) with effect from 1 October 2005. As the Group publishes comparative information for one year in its financial statements, the date for transition to IFRS was 1 October 2004, which represents the start of the earliest period of comparative information presented. This is accordingly the first full set of financial statements prepared under IFRS.

As the South African Institute of Chartered Accountants (“SAICA”) had embarked on a convergence process with the standards as set out by the International Accounting Standards Board (“IASB”) in the late 1990s, the effect of the transition to IFRS is not as dramatic in South Africa as has been experienced in other countries making the transition.

The financial statements are prepared in accordance with and comply with IFRS. As a result of the similarity between South African Statements of Generally Accepted Accounting Practice, as previously applied, and IFRS, the principal accounting policies as set out in the 2005 annual report have been consistently applied, except for the policies stated below:

Share-based payments

The Group grants share options to employees under employee share incentive schemes. In accordance with the requirements of IFRS 2, the Group has recognised an expense in the income statement, with a corresponding credit to equity, representing the fair value of employee share options granted. The full fair value is recognised as an expense over the vesting period of the options.

The effect of adopting this statement is a total charge of R78 million for the current year. R5 million relates to options issued in 2004, while R13,1 million and R65 million relate to the current year option issue and the HPFL transaction (BBBEE scheme), respectively. It should be noted that the current expense in respect of the HPFL transaction is considerably lower than the original forecast of R93 million due to less unit trusts being issued than was originally planned. These unit trusts are likely to be issued in coming years and will be expensed at such time.

Employee benefits

In line with the provisions contained within IAS 19 – Employee Benefits, the Group has elected to recognise all actuarial gains and losses directly in equity in the year in which they arise. The effect of this change is not material.

Capital distribution

The Board of Directors has declared a final capital distribution out of share premium of 15 cents per ordinary share, payable to shareholders recorded in the register of the Company as at Friday, 19 January 2007. Taken together with the interim distribution of 12 cents per share, the total distribution paid and to be paid in respect of the 2006 financial year, amounts to 27 cents (2005: 25 cents) per ordinary share, an increase of 8% over the period.