

## Chief executive officer's review



**It has been a year of intensive activity on all fronts. In the first year of Netcare's second decade, we have so much to be proud of, and much more still to do.**

**Dr Richard Friedland** *Chief Executive Officer*

A handwritten signature in black ink on a white background, which appears to be 'Richard Friedland'.

Health impacts every aspect of a nation's development and is equally important at every stage of an individual's life. Globally, there is a fault line that separates those who have access to affordable quality healthcare and those who do not. Where people do not have the means to access healthcare, their choices are constrained and their quality of life impaired. People on the wrong side of the fault line find it difficult to escape the cycle of poverty and disease. Those on the other side, however, with access to a wide range of healthcare services at every stage of their lives, from primary care to sophisticated surgery, are able to develop and prosper – to live longer and fuller lives.

Throughout the developed and developing world, one of our biggest challenges is to make affordable, accessible quality healthcare a reality for the present, not a hope for the future. This is a challenge that the governments in both our markets rightly take very seriously. As a leading healthcare organisation in South Africa and the United Kingdom, we are just as serious about participating in meeting this crucial challenge.

We also appreciate that our ability to contribute meaningfully to viable and sustainable healthcare solutions is contingent on creating value for our shareholders. It is a mark of the skill and compassion of Netcare's people that we have again managed to strike the delicate balance required to both respond to healthcare challenges as well as sustain our profitable growth as a healthcare company.

The case studies that are interwoven throughout our annual report this year provide stirring examples of the many ways in which Netcare is making a profound, positive impact on people's lives at many different levels. They also illustrate what we all can ill afford to forget while the debate about the quality of healthcare delivery and expenditure rages on: the fact that there are real people behind those statistics and it is their needs that should hold our attention.

## Strategic review

In both our markets, growing demand for private healthcare is being driven by the increasing incidence of lifestyle diseases such as obesity, high blood pressure, high cholesterol and type-2 diabetes. The phenomenon of ageing populations is also resulting in increased use of our facilities and lengthier stays. As advances in medical technology enable earlier diagnosis and new treatment protocols are developed for conditions that previously were inoperable, these too drive demand.

### South Africa

South African healthcare is facing major challenges such as a chronic skills shortage, an underfunding of public health and an increasing burden of disease; all within the framework of an inherited healthcare system characterised by over 40 years of inequity. The key challenges that stem from this are those of access, affordability, quality of outcomes and skills.

Netcare is firmly committed to addressing this inequity and ensuring that the private sector plays a responsible and constructive role in addressing these issues. To significantly widen the avenues of access and build sustainable healthcare delivery models, we need to accelerate the implementation of Public Private Partnerships (PPPs) and Public Private Initiatives (PPIs). In our PPPs with government, we advocate moving away from the traditional model of build, operate and transfer towards the provision of full clinical services on a similar basis to those provided for the National Health Services (NHS) in the UK.

We believe that well-considered PPIs can provide meaningful and targeted improvements to healthcare delivery. Again, we have the experience gleaned from the model applied in the UK, where the private sector provides clinical services to the public sector which include making capacity available to reduce waiting lists for elective surgery, such as hip replacements and cataracts, as well as rolling out mobile healthcare services to rural areas. An important opportunity exists to assist the public health system where capacity is available. A good example of private and public sector cooperation was provided during the public service strike in South Africa, in which the necessity of

urgent intervention encouraged the effective and coordinated utilisation of resources. We are committed to extending and building on this level of cooperation in order to contribute to widening healthcare access.

In terms of affordability, much criticism is placed on the private sector in terms of the escalation of hospital expenditure. Detailed analysis proves that this is not purely as a result of the consolidation of the hospital sector and the perception of related price escalation, but rather has much to do with the increased utilisation driven by an ageing population and increased prevalence of lifestyle diseases. Netcare's hospital weighted average price increase for the past year was 5,7% and at a primary care level the average effective price increase was 2,6%, both well below the average consumer price index of 6,3%.

In the year we were widely criticised for our pricing model, one used by the sector for many years and currently used by at least 70% of private hospitals. In terms of this model, rebates on surgical and consumable goods were offered by suppliers on commercial terms. In turn these discounts cross-subsidised the under recovery in ward, theatre, equipment and accommodation fees (some 55% of an average hospital bill but approximately 70% of costs). While this cross-subsidisation billing system was poorly understood, it was neither illegal nor unethical. We acknowledge, however, that it did not provide full transparency of pricing and we have committed to removing all rebates on surgical consumables from January 2008.

Much mention has been made of the importance of Alternative Reimbursement Models (ARMs) as a potential solution to addressing increases in healthcare expenditure. Alternate methods of reimbursement aim to transfer risk to healthcare providers and in so doing, align incentives between the medical scheme and healthcare provider. Netcare has undertaken to convert a substantial portion of our fee-for-service pricing model into an alternative reimbursement and risk sharing model with funders. By January 2008, approximately 40% of all procedures will be on an alternative reimbursement model and we aim to achieve 60% by the end of 2008.

We commend government for initiating the National Health Reference Price List (NHRPL), which will provide an enhanced understanding of the cost drivers in private healthcare. Together with industry, we are working on an appropriate pricing model for hospital providers in terms of the NHRPL.

Adherence to the highest standards of quality in healthcare delivery is underpinned by clinical governance protocols that promote best clinical practice and mitigate clinical risk. Netcare

has invested significantly in clinical governance in recent years and our quality assurance board committee has now been elevated to a full board committee. We also continue to benchmark ourselves against stringent international standards. Netcare's performance is world class, evidenced by a number of quality indicators. In terms of hospital acquired infection, against an international benchmark of nearly 9,3 per 1 000 patient days, Netcare achieved 2,6. Similarly, our mortality rate in relation to admissions is 1,1% against an international average of 1% to 3%. Looking ahead, we will be presenting our performance against these quality indicators to government on a quarterly basis.

South Africa's chronic skills shortage is aggravated by the high demand for our nurses overseas, particularly in Canada, Australia and the Middle East. While this is testimony to the quality of training they receive in South Africa, it creates a challenge that cannot be addressed by increasing nurses' salaries.

In the year, our overall cost of training in South Africa was R100 million. We trained over 3 200 nurses and some 500 paramedics and we are the largest private nursing and paramedic training institution in the Southern Hemisphere. We continue to implement new models of care to optimise the utilisation of skilled nursing staff. We are also part of the Homecoming Revolution campaign to bring South Africans home and have repatriated around 60 nurses this year alone, with another 100 expected in the near future. Although we have accelerated our training efforts, there is obviously a lag factor in the training pipeline. Accordingly, we have applied to the Department of Health for a licence to import nurses from central Europe, the United Kingdom and India.

## **United Kingdom**

The market has undergone significant changes over the past year. New entrants into the private hospital sector will increase the competitive landscape and potentially lead to a consolidation of the sector. The NHS has also moved away from centrally procured outsourcing contracts to more locally driven procurement of clinical services and procedures.

Importantly we have been able to transfer much of Netcare SA's DNA to the UK. Netcare's performance-driven ethos, certain operating models, including our doctor-centric approach and nursing staffing models have been adopted by our UK management team and in certain cases improved upon. In the last year, the two-way flow of intellectual capital, management expertise and practical experience between our South African and UK businesses has already proved valuable.

Within GHG, an organisational metamorphosis has occurred. We now have an almost entirely new executive management team at the helm. We continue to restructure and align the

business both at an operational and corporate level. Strong headway has been made in streamlining the business and extracting efficiencies, consolidating our central services functions including finance, IT and HR, into one central location. We have focused on strengthening each of our hospital's local identity and have established individual business and marketing plans for the next financial year. Marketing plans will promote the consistency of service and confidence associated with the GHG brand.

To promote our 5 000 self-employed doctors in the UK and to differentiate our service offering further, in 2007 we roll out further practice development groups, bringing together doctors with specific specialist expertise with the related ancillary services. Our aim is to consolidate our strengths in these areas thereby creating centres of excellence. We are confident that the centres will attract increasing numbers of leading doctors and we are launching partnership schemes to help achieve this.

There are a number of new services ranging from cosmetic surgery and weight loss to more major surgery providing opportunities for GHG. We also see opportunities in the private medical insurance field and are working in partnership with funders to find innovative access routes to increase the private medical insurance base in the UK, which has been flat for the last five years.

This year also saw us successfully mobilise three new NHS contracts. While we were disappointed to see some of our central "Phase 2" NHS contracts cancelled, GHG is well positioned to benefit from the trend to localised procurement, given its extensive geographic network and proven ability to deliver quality outcomes cost effectively. All our hospitals will be IT enabled by the end of 2007. This will enhance our ability to service the government's Extended Choice Programme, which will give NHS patients who have been on a waiting list for definitive treatment for longer than 18 weeks, an extended choice of providers. While the numbers of patients on waiting lists for elective procedures in the NHS continues to decline, as of June 2007 it was estimated that approximately 54% of patients on such lists were waiting longer than 18 weeks from the time of GP referral to definitive surgery.

## **Financial review**

Netcare's performance in the year under review was characterised by significant organic growth in South Africa and substantially improved operating efficiencies in the United Kingdom.

Group operating revenue from continuing operations increased significantly as a result of including GHG for the full year. This increase of 66,8% to R18 607 million was also driven by strong revenue growth of 14,9% in South Africa. Group operating profit from continuing operations increased by 89,5% to R2 990 million with South African operating profit growth of 13,6% to R1 406 million, and UK operating profit of R1 646 million. The Group operating profit margin expanded from 14,1% to 16,1% as a result of the full year consolidation of GHG with comparatively higher margins than those in South Africa. In the UK, our efficiency initiatives translated into core earnings before interest, taxation and depreciation growing around 14% compared with the comparative 12-month period.

Group headline earnings per share increased 75,2% to 77,6 cents per share. In South Africa, basic headline earnings per share increased by 18,3% from 65,2 cents (restated) to 77,1 cents per share. As expected, GHG reduced headline earnings per share by 15,3 cents to 61,8 cents per share, before considering the credit to income arising from the change in the UK corporate tax rate. The tax credit improved headline earnings per share by 15,8 cents to 77,6 cents. Adjusted Group headline earnings per share increased by 26,6% from 48,8 cents to 61,8 cents.

### Looking ahead

In South Africa, we will continue to engage with government pro-actively and constructively to address government's concerns regarding affordability of private healthcare and the inequity of public private healthcare provision and our proposed solutions.

The two main drivers of growth will remain the increase in the medically insured population and higher demand for private health care from a self-pay market, reflecting the growing affluence of the emerging middle class. We expect these trends to continue, particularly in view of the impact of the Government Employee Medical Schemes (GEMS), which has been the most significant contributor to growing the country's traditional medical aid base.

With 48 acute hospitals across the country, GHG is already the leading private healthcare provider in the UK, and Netcare UK is an established partner of choice to the NHS. Looking ahead, we will actively build on these platforms. Close alignment with Private Medical Insurers (PMIs) in order to grow the number of lives covered by PMI is a major priority for the Group.

### Management priorities

In 2007, our management priorities in the UK included reviewing our diagnostics services and actively engaging with

consultants. We completed our diagnostic services review and identified ways to rationalise our services in certain areas and extend our services in others. Initiatives implemented as a result of our doctor-centric model included establishing several practice development groups.

Priorities for the year ahead include increasing our share of business from new NHS activities, and strengthening the growth platform we have established by enhancing our competitive position. This will entail dedicated focus on building out our doctor-centric model and on customer service. We believe we can strongly differentiate GHG in terms of service and have identified several opportunities, from hospital pre-admission through to discharge and follow-up procedures.

In South Africa, our priorities were the commissioning of the two greenfields hospitals, which we achieved. We also made progress in a key strategic initiative, the roll-out of SAP. The Community Hospital Group (CHG) has established a track record of providing high quality, cost-effective medical care, and in 2008 a key priority will be to complete the integration of CHG into Netcare. An important priority on the pricing front will be to implement the new risk sharing models with our funders.

An ongoing priority is to strengthen our partnership with Government to accelerate the provision of accessible and affordable healthcare. As we build a South Africa we can all be proud of, accelerating transformation remains a priority – not only in seeking an improved BEE accreditation but in our desire to influence real change in the hearts and minds of our employees and other stakeholders towards a society that celebrates its diversity and is free of discrimination.

### Appreciation

Once again it has been a year of intensive activity on all fronts. In the first year of Netcare's second decade, we have so much to be proud of, and much work still to do.

As we look ahead to another year of exciting opportunities and complex challenges, I know the people of Netcare will once again demonstrate their diverse talents and deep humanity both in taking this organisation forward and providing a critical service to the citizens we serve. My heartfelt thanks to all our employees for your dedication in making Netcare the market leader it is today, and your commitment to our higher cause.

I extend my thanks to our Chairman, Mr Michael Sacks, for his steadfast commitment to Netcare and wise counsel. I also thank the board for their ready support and critical input as we move into a new era.