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The forecast is fair for Sea Harvest

Lizelle van Rooyen - Associate Analyst

"Established in Saldanha Bay in 1964, Sea Harvest is one of South Africa's largest and best recognised fishing groups. This year it listed on the JSE Securities Exchange. As a vertically integrated company, the business owns its own trawling vessels and processing facilities and distributes its branded frozen seafood products around the globe."

The forecast is fair for Sea Harvest

The bulk of its operations are in South Africa, focused on the catching, processing and marketing of Cape hake, found along the Southwest coast of southern Africa. Last year, the group expanded its geographic presence with the acquisition of a controlling stake in Australian-listed business Mareterram, which catches and markets prawns. Brimstone Investment Corporation holds a 55% majority share in Sea Harvest, contributing to the group's strong BEE credentials, which are important for securing fishing rights in South Africa.

Sea Harvest operates a sustainable fishing business and has made significant recent capital investments to improve efficiencies and increase its export capabilities. We believe the group is well positioned to benefit from demand for wild-caught seafood in both local and international markets.

A sustainably managed resource

Hake is a white fish found along parts of the Atlantic and Pacific Ocean coastlines. Cape hake accounts for roughly 29% of global hake supply, with around 50% of it sourced from South Africa and 50% from Namibia.

Since 2004, South Africa's hake fishing industry has been certified by the Marine Stewardship Council (MSC)[1] - a rigorous sustainability standard which requires, among other criteria, that annual catch volumes are kept to a renewable threshold. South Africa is one of the few sustainably managed hake fisheries worldwide, but historically this was not the case.

In the 1960s, South Africa's productive waters attracted many international fishing fleets. Hake catch volumes swelled to more than double the limits of today, and falling population levels threatened the industry's future. In 1977, the UN's Exclusive Economic Zone regulation gave coastal nations sole exploitation rights over their natural resources, and foreign fishing activity along South African shores was phased out. Since then, an annually revised total allowable catch (TAC) has been enforced based on scientific guidance to ensure sustainability and stocks have significantly recovered.

Successful fishing right applicants are granted a 15-year right to a proportion of the annual TAC. Commercial fishing companies are granted fishing rights mainly based on the applicant's transformation credentials, capacity, past performance and employment-creation track record. Sea Harvest currently has access to 28% of the hake TAC (see chart), which reflects the company's strong BEE credentials and employment track record. The group is a significant job creator in the rural areas of Saldanha Bay and Mossel Bay where it employs more than 2 400 people. The next fishing-rights allocation assessment will be held in 2020, for which we believe the group is well positioned.

[1] The MSC is a non-profit, independent global organisation which assesses if a fishery is well managed and sustainable.

Sea Harvest's vertically integrated operations

Sources: company reports, Kagiso Asset Management

In addition to protecting the industry's sustainability, MSC-certification provides access to sophisticated markets where eco-labelling detailing a product's sustainability credentials is a requirement. Eco-labelled fish products trade at a premium, which is evident in the price differences achieved between Namibian (non-certified) and South African hake.

Industry dynamics result in premium pricing

Global fish consumption has reached all-time highs. According to the Food and Agriculture Organization, seafood currently accounts for roughly 17% of all animal protein consumed globally and is as much as 50% in some countries. Demand for fish is expected to continue to climb as a result of population growth, shifting dietary patterns in favour of higher protein consumption, international trade providing wider consumer choices, and growing awareness of the perceived health benefits of seafood. However, while demand has grown, the supply of wild-caught fish has been stable for the last three decades at around 90 million tonnes a year (graph over the page), with 32% of fish sources overfished and most of the rest optimally fished.

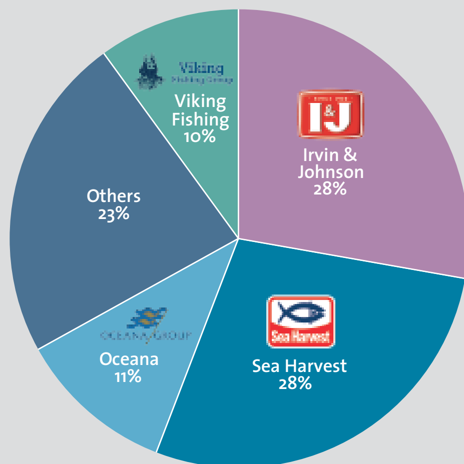
Commercial fish farming, known as aquaculture, has grown rapidly and is responsible for the growth in the supply of fish (today accounting for 44% of global seafood production and more than 50% of fish for human consumption). However, hake aquaculture is not a commercially viable practice and hake supply remains limited to wild-caught volumes.

This strong growth in demand for a resource with limited supply will enable producers to continue to command strong prices. Sea Harvest has well-established long-term relationships with an international customer base, and is positioned to benefit from this price dynamic.

In South Africa, Sea Harvest is an iconic brand with a leading 37% retail market share in frozen fish. It has consistently achieved above-inflation price increases in recent years. The retail price for frozen hake has grown at an impressive 9.2% per annum since 2008. An exclusive agreement to pack frozen Cape hake and kingklip for Woolworths adds a further 7% to the group's domestic retail market share.

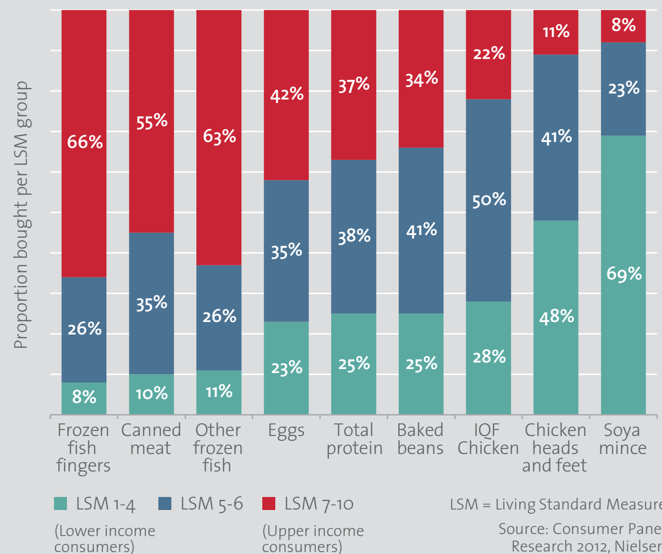
Frozen fish penetration in the SA retail sector remains low relative to global levels and other proteins, with higher LSM-consumers the primary buyers of frozen fish. There is therefore significant scope for growth in retail hake consumption in SA. This indicates that the sector is positioned for growth over the long term as disposable income levels increase and consumers become more health-conscious. Sea Harvest's strong brand, and its ability to bring innovative products to the market, perfectly places the group to benefit from a step-up in local consumer demand.

Current SA hake fishery quota allocation



Source: Sea Harvest

SA food category consumption breakdown



Source: Consumer Panel Research 2012, Nielsen

The forecast is fair for Sea Harvest

Improved profitability expected

Over the past three years, Sea Harvest has made significant capital investments into profit-enhancing projects for its fleet and manufacturing facilities. This includes the addition of two new factory freezer trawlers, which increase the group's capacity for frozen-at-sea products. These products are targeted at the export market, predominantly Europe and Australia, and are more profitable due to the higher pricing in these markets.

Cape hake is well-recognised internationally and is priced as a premium fish. Sea Harvest currently exports around 40% of its volumes and has a target to increase this to 50%, while reducing its current proportion of sales to the local foodservice industry which attracts lower margins. This shift towards higher margin export sales should be accompanied by higher profitability.

A further factor likely to enhance the group's profitability is an expected improvement in hake catch rates following a reduction in the TAC in 2015 and 2017. Catch rates refer to the volume of fish caught per vessel per fishing day and are correlated to fish population levels. Higher catch rates are therefore more efficient and result in reduced trawling costs per kilogram of fish caught. From a peak in 2011, catch rates declined to a low point in 2015. With a reduction in the TAC and a recovery of the population, catch rates are expected to increase, in turn reducing average trawling costs and improving profitability.

Platform for growth in Australia

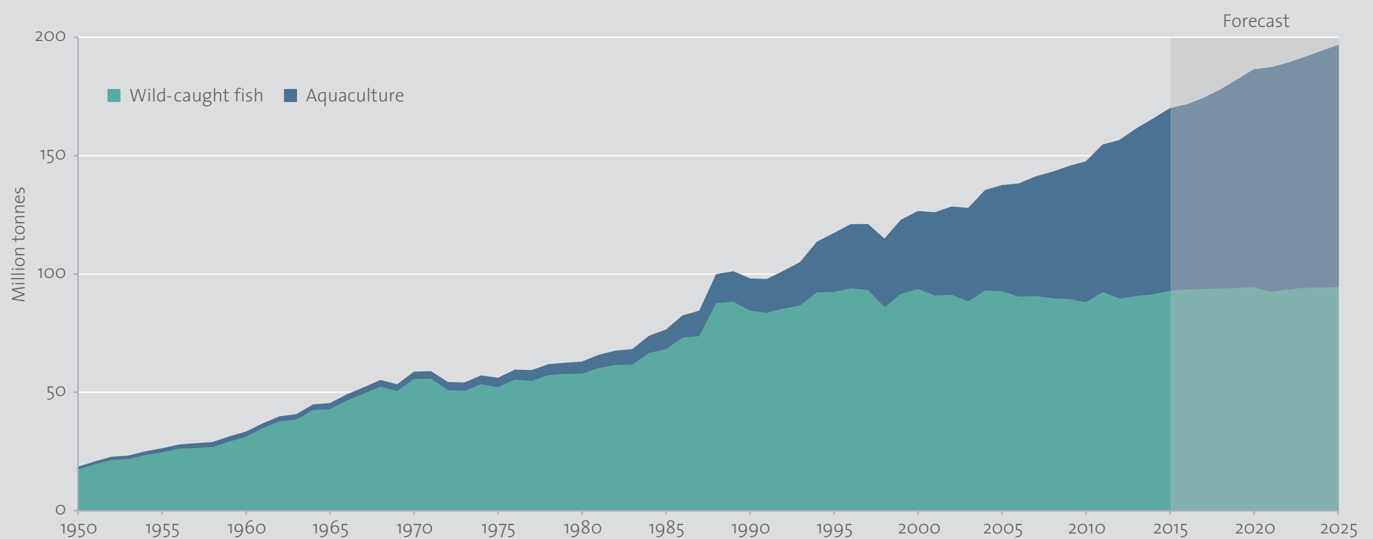
Mareterram primarily catches prawns in Western Australia, the most widely consumed seafood in Australia. The fishery is MSC-certified and, in contrast to South Africa, Australian fishing rights are allocated in perpetuity and treated like a property right. It holds a 5% market share in the wild-caught prawn industry in Australia. Similarly to Sea Harvest's SA operations, it is a vertically integrated group and has its own food service segment that provides a pathway to the market for Mareterram-caught products and other imported frozen seafood and potato products.

This acquisition allowed Sea Harvest to diversify its product offering and earnings and serves as a platform to potentially consolidate the fragmented Australian fishing sector through further acquisitions. With its proximity to the growing Asian markets, Australia is an attractive market in which to operate.

Further upside expected

Sea Harvest's recent investments position it for ongoing growth and higher profitability in the coming years. The group has exciting opportunities for both organic and acquisitive growth in South Africa and Australia, and its strong balance sheet and experienced management team give it robust capacity to act. Investors in our funds will gain valuable exposure to this growth. UP

Global seafood supply



Specialisation and scale at Santam

Justin Floor - Portfolio Manager

The *'Suid-Afrikaanse Nasionale Trust en Assuransie Maatskappy Beperk'* (Santam) was established in Cape Town in 1918. Just shy of 100 years on, it is the largest short-term insurance company in South Africa, with a market share of 22% (roughly double that of its nearest competitor) and a R28 billion market value. It provides cover to more than 1 million policyholders in the corporate, commercial and personal markets - with 80 of the top 100 companies listed on the JSE Securities Exchange currently insured with Santam.

Specialisation and scale at Santam

Competition within the South African short-term insurance market is stiff, and current local economic headwinds and significant regulatory reforms place further pressure on the sector. We believe that Santam's scale, diversified risk exposures and portfolio of high quality specialist businesses position the company to navigate these challenges well and achieve continued growth.

Under the umbrella

The Santam Group is 60%-owned by respected financial services conglomerate Sanlam and benefits from a strong partnership with its parent company. Santam comprises an unrivalled portfolio of diverse insurance businesses offering products broadly grouped into: motor, property and specialist lines (pie chart below).

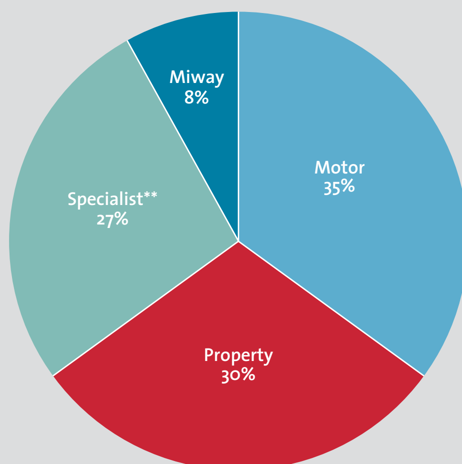
The Santam Commercial and Personal division provides motor and property cover to individuals and institutions through a national network of more than 2 700 intermediaries. The Santam brand is well-recognised in these markets and attracts loyal business.

Wholly-owned subsidiary, Miway, offers primarily motor and property cover to individuals. The business gives Santam exposure to the fast-growing 'direct' insurance market, selling policies straight to customers through its call centre and online platform. Launched in 2008, Miway has successfully carved out a place in a highly competitive market, holding its own against competitors such as Outsurance and the Telesure Group brands (which include Dial Direct and First for Women). Well run direct insurance businesses can offer sustainably higher margins and cost efficiencies (often due to their emphasis on new technology) once scale is reached. Miway has achieved consistently above-average profitability and strong growth, and we expect these trends to continue.

Included under the Santam Specialist division are a variety of highly-skilled underwriting management agencies. These are specialised insurance businesses with the deep technical expertise to underwrite niche risks. Whether it's the engineering on the construction of a complex infrastructure project, a cargo ship or sailing yacht, a fleet of heavy commercial vehicles or the indemnity cover for a medical professional, there's a highly-skilled team within the Santam fold, equipped to insure the risk.

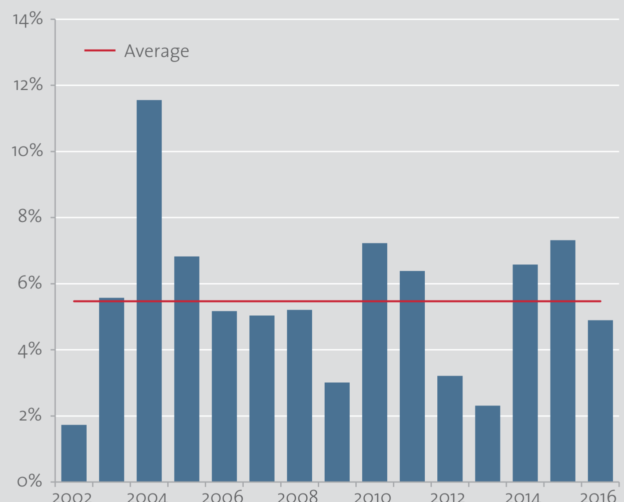
These high quality businesses are the jewel beneath the yellow umbrella and have contributed disproportionately to Santam's profitability over time. They have demonstrated sustainable, superior profitability in the form of higher and more consistent margins than any other division of the business. Relatively low competition in these specialist niches, and the critical importance of data and risk evaluation and pricing skills, results in excellent pricing power for the division.

Santam's business mix*



*2016 gross written premium
** includes Liability, Engineering, Crop, Transport, Accident, Guarantee and Alternative risk transfer.
Sources: company reports, FSB and Kagiso Asset Management research

Santam's underwriting margin history



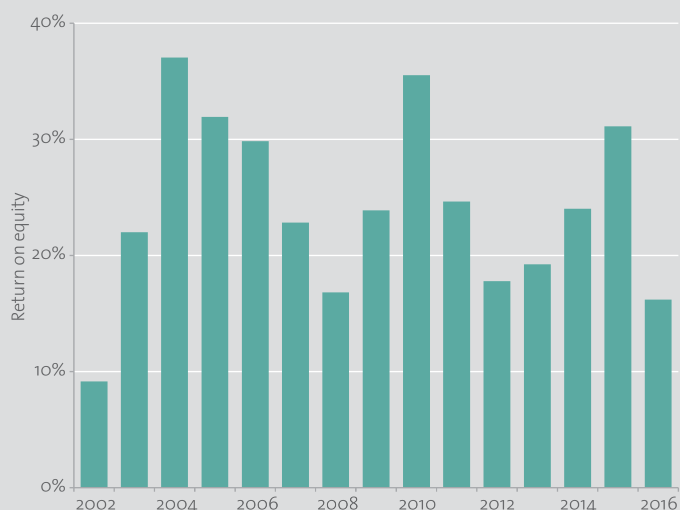
Source: company reports

Attractive characteristics

The Santam business offers a number of key positive attributes which strengthen its competitive position:

- **Scale:** Scale is critical for insurance companies, providing increased access to data (enabling improved risk analysis to inform accurate pricing) and an ability to diversify across different risks. In addition, economies of scale on fixed overhead costs result in higher margins.
- **Diversification:** Santam insures risks that are diversified across type, customer and geography. This diversification enables the group portfolio to consistently deliver stable, positive margins, despite the cycles and volatility of different businesses and risks over time.
- **Stable and high returns on capital:** These strong returns over time indicate the high quality of the group and its robust business model with demonstrable pricing power (see chart below).
- **Consistent profitability and free cash flow growth:** This is evidenced in the consistent dividend over time, offering shareholders a 12% compounded annual growth rate in the dividend per share since 2002, including special dividends (see chart over page).
- **Shareholder-centric philosophy:** Santam has consistently managed the company with shareholders in mind. Its dividend growth illustrates capital allocation decisions over time, and it is evident that most cashflows find their way to shareholders, with minimal amounts of debt issuance along the way. The business generates sufficient cashflow over time to finance its growth ambitions without recourse to external capital injections which would dilute existing shareholders - a further significant attribute.

Santam's consistent returns over time



Source: company reports

A capital change

Following the Global Financial Crisis, risk management across the entire financial services industry came under the magnifying glass. In line with the reformed insurance capital management regulations implemented in the European Union, South Africa has introduced Solvency Assessment and Management (SAM), due for implementation in 2018.

SAM is aimed at protecting policyholders by ensuring that insurers are able to meet their financial obligations and introduces a 'risk-based' approach to capital management. Previous regulation required that short-term insurers held a fixed percentage of all premium income as capital. SAM will now require that capital requirements are calculated according to a standard formula, or internal model, which takes into account the riskiness of the underlying liabilities, nature of the backing assets and diversification of the entity.

For many local competitors, the change is likely to mean a substantial increase in the amount of capital they are required to hold, with mono-line players in commercial lines being worst affected because they have no diversification to offset their risk. For Santam, however, we expect the change to be negligible as the group's size and diversified portfolio will significantly reduce its risk.

The effect of this differential in capital requirements will benefit Santam. As competitors' businesses become more capital intensive, they will be forced to increase their pricing to earn an adequate return on capital, or, ultimately, will have to close or dispose of their businesses. This is an opportunity for Santam which has capital to make acquisitions and can use its scale and lower cost of capital to run these businesses more profitably. The group has demonstrated its capacity for opportunistic consolidation in two recent deals: its acquisitions of Rand Merchant Investment Holdings' specialist insurance business, and a book of commercial business from Absa.

Specialisation and scale at Santam

International expansion

Santam has partnered with Sanlam's international division, Sanlam Emerging Markets, to pursue further opportunities for growth in emerging markets in Africa and Asia. In terms of the partnership, Santam takes a 35% shareholding in all short-term insurance business outside of South Africa.

The recent downturn in the commodity supercycle has resulted in economic and currency weakness in Santam's emerging market businesses, dampening their near term prospects. However, this is not reflective of their underlying potential and a return to a normalised environment will highlight their strong positioning, above average profitability and higher growth trajectory over time. We believe them currently to be an undervalued and underappreciated component of the Santam investment case.

The insurance industry in these markets is underdeveloped and penetration is low. As incomes rise and urbanisation continues, Santam can harness the skills of its specialist businesses to provide cover for large-scale infrastructure projects. Its personal lines offerings in these markets are also positioned to benefit from trends towards rising incomes and ongoing rapid urbanisation.

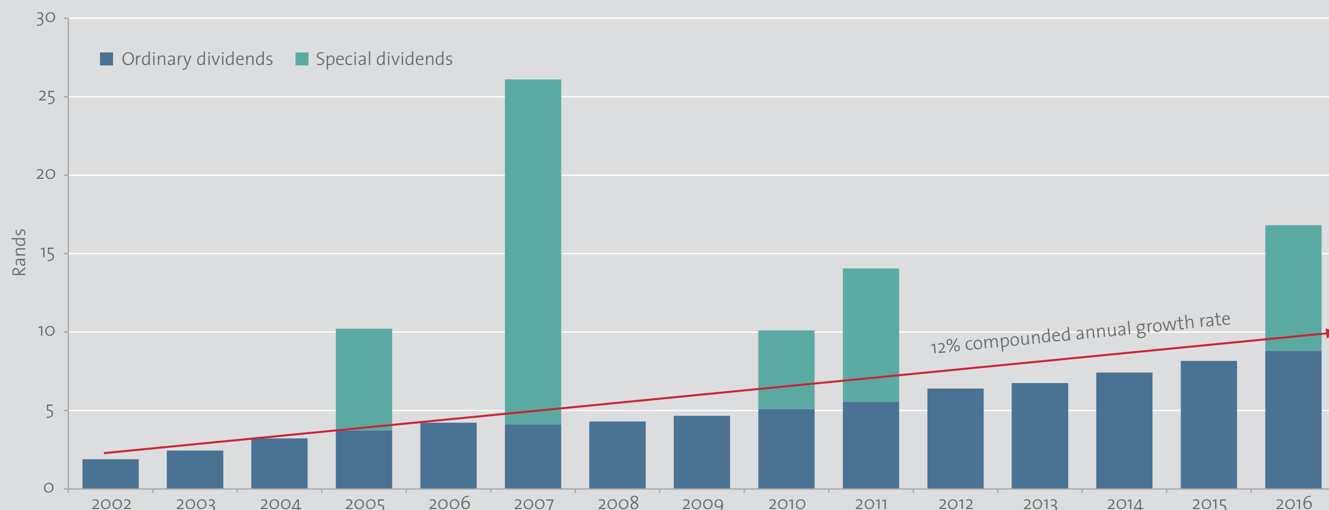
Conclusion

Santam is in an extremely strong competitive position with its scale, diversified portfolio and cost efficiency allowing it to be a net beneficiary of upcoming regulatory changes. As competitors experience an increased cost burden, it is well placed to profitably deploy capital into highly accretive consolidation activity in the years ahead.

It earns high returns on capital and has a long runway of profitable growth ahead. We expect growth in South Africa to be reasonably steady (nominal GDP growth is a useful starting point) with incremental benefits from market share gains and the faster-growing Miway business. The group's international exposure remains under-appreciated and over time will add significant value to its financial statements.

Ultimately, Santam meets all the criteria of an enduring, appreciating business and we expect our clients to continue to enjoy the benefits of owning such a high quality business over time. UP

Santam's growing dividends per share



Source: company reports

Wolters Kluwer: essentials for professionals

Jihad Jhaveri - Head of Process

> Wolters Kluwer is a Dutch-listed global information services company, providing professionals with synthesised technical information and workflow tools.
>
> With a presence in 150 countries, the company can trace its roots to the Netherlands in the middle of the 19th century.

Wolters Kluwer: essentials for professionals

At that time the country was in the midst of a period of heightened constitutional and regulatory flux. Contributing factors were its relatively late industrialisation, colonial legacy, outsized position in seaborne trade and complex provincial administration systems. There were also its unique body-of-water regulations stemming from the country's singular accomplishments in land reclamation that necessitated complex rights and responsibilities in water management.

This environment of complexity and change spurred demand for educational and informative literature, and led to the growth of a number of entrepreneurial family publishing houses, later consolidated to form Wolters Kluwer. These early publishing houses shared common characteristics:

- A focus on synthesis. The adaption of complex legal and accounting legislation into more easily understood language. While the underlying source content would always be publicly available, professionals would pay a premium for distilled, easy to use, current and reliable information.
- Use of a deep network of technical legal, tax and medical experts. This network would form the core basis of its competitive advantage.
- Supplementary information products with ancillary services, including regular magazines with updates, commentary, and analysis. Innovative products were developed to enhance content communication (for example, a popular pop-up book for medical education).
- A focus on embedding products and services in the core workings of businesses, educational institutions and the large civil service, enabling strong client retention.

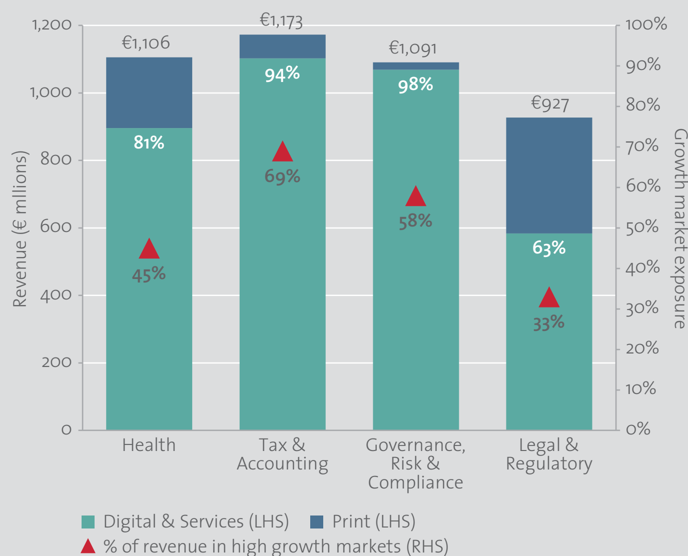
Following a recent decade of acquisitive growth, Wolters Kluwer has become a significant global electronic content and software company. As a modern business, 83% of its revenue is now earned from digital products and services, yet the core characteristics of the early Dutch publishing houses remain central to its business model today.

Healthcare

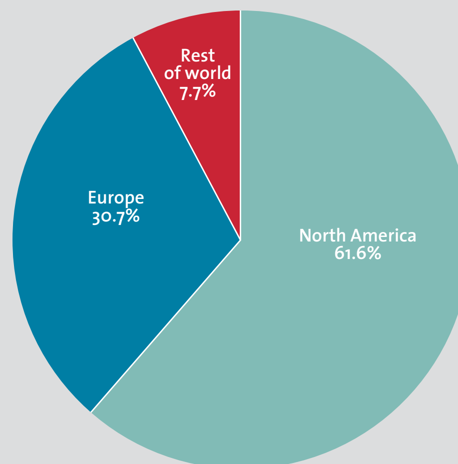
Wolters Kluwer's healthcare division provides practical assistance tools to help healthcare professionals improve the quality of their work. The products are specialised for pharmacists, nurses, medical researchers and doctors.

One such product is 'UpToDate', a multi-functional cloud-based mobile application for doctors. The basis of this system is a research engine of 6 500 physicians, authors, and peer reviewers that systematically review the ever-increasing flow of new medical information (often in the form of published journal research). The review provides a synthesis of the most

Wolters Kluwer's divisional revenue split



Wolters Kluwer's geographic revenue split



Sources: company data, Credit Suisse estimates

current, evidence-based medical recommendations. The software teams are then responsible for ensuring efficient content delivery.

UpToDate is widely used by healthcare professionals around the world from student to specialist level, and is popular in South Africa in both the public and private sectors. The app is packaged as a continuously updated 'mobile textbook' that provides quick summary answers to clinical questions, as well as seamless drill-down into tables, graphics and decision algorithms. It is designed to enable quick referencing, as well as more detailed research and can be used to efficiently fulfil continuous professional development requirements as it is able to track user search and research histories.

The tool's value at the point of important decision-making in the clinical setting has built a loyal global subscriber base of 1.3 million clinicians.

Tax and accounting

This division provides synthesised information on the latest tax and accounting regulations, packaged in a user-friendly format for professionals. The division also provides specialised accounting and tax workflow software packages for accounting firms, and the internal finance departments of corporates. Well known competitors include Thomson Reuters and Sage.

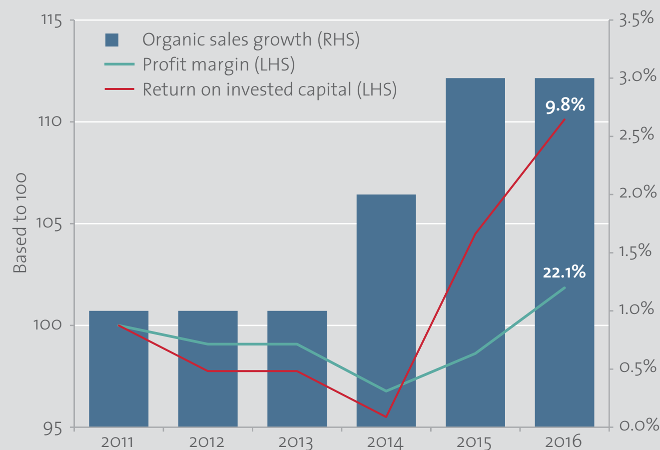
This division has strong positions across Europe as well as North America. The revenue base is highly digital (only 6% of revenue still comes from print) and has a very high subscription base (93% of revenue is recurring). Once adopted by a business, these software packages become central to the company, creating strong customer retention for Wolters Kluwer.

We believe that expected changes to the United States tax system promised by the Republican government will be a positive for the company, increasing demand from professionals for synthesised information products and updates. The US tax system is particularly complex, with a web of tax codes at the national, federal and local level, meaning significant resources required for compliance.

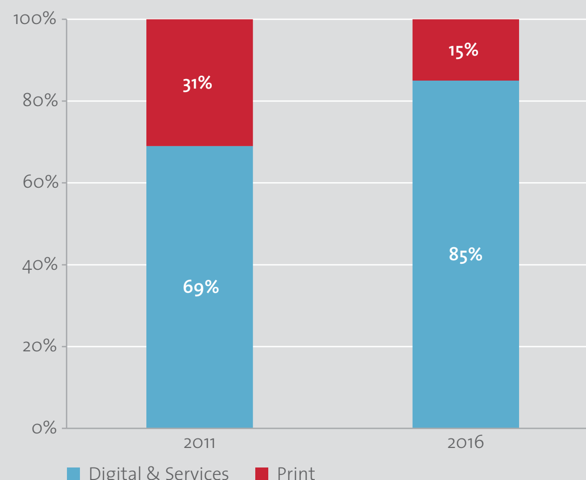
Governance, risk and compliance

The governance, risk and compliance division provides workflow tools in the form of embedded software packages to help corporates comply with changing regulation, with regulatory reporting requirements and with asset and collateral management. Typical users would be professionals in the legal, compliance, risk and internal auditing departments of industrial corporations and financial services companies (banks and insurers). This division's revenues are almost entirely digital, with attractive margins.

Wolters Kluwer's key performance trends



Digital and services: revenue mix for Wolters Kluwer



Source: company reports

Wolters Kluwer: essentials for professionals

Legal and regulatory

Drawing from its historic roots, Wolters Kluwer is a dominant provider of synthesised legal content in the Netherlands, Belgium and Sweden and a leading player in a number of other European countries. The localised nature of legal systems (both their intricacies and languages) makes its strong presence in some European countries an advantageous niche position. The division also offers workflow tools in the form of end-to-end legal practice management.

This division has been the slowest to digitise (37% of revenue still comes from printed products) which gives it exposure to a number of challenges related to the digital migration process. Revenue growth is currently poor, and margins are low.

Death, taxes and cash flow

The underlying demand for the company's products is non-cyclical, servicing the day-to-day essential needs of consistently in-demand professionals.

We also believe the underlying demand growth is enhanced by a number of structural challenges facing professionals:

- The increasing quantum and complexity of developments in all its sectors: healthcare, financial services, law, and tax and accounting.
- The increased pressure on professionals to deliver measurably better outcomes, at lower costs.
- The increase in the number of professionals globally, as emerging markets develop their services sectors, further entrenching the need to enhance competitiveness and improve outcomes at reduced costs.

The defensiveness of the Wolter Kluwer model is amplified by the high percentage of revenue that is received through recurring subscriptions, creating an ongoing cash flow benefit to the company.

However, despite these positives, the company's revenue growth has historically been low, with organic revenue growth only recently picking up, and margins relatively static for a number of years. The key reason for this is that the company, like many other content publishers, has had to overcome challenges as it moved from print-dominated product offerings to digital. The key challenges include:

- Until critical digital mass is achieved, there is typically a long period where the decrease in print revenues is not entirely offset by the increase in digital revenues, due to their different pricing points.
- Dual production costs (both print and digital) must regularly be carried, which hurts margins. Publishers are often in a perpetual state of restructuring, incurring regular, large "once off" costs in order to retrench redundant staff. The company's trend in restructuring costs has now turned down sharply.
- Not all business lines are capable of being transformed digitally in a profitable manner. Over the last decade, like many competitors, Wolters Kluwer has chosen to aggressively dispose of many of its print-dominated businesses, and has spent a large amount of its free cash flow on the acquisition of digital businesses with better growth prospects. This is often a risky strategy for shareholders with well understood, cash generative assets sometimes sold at low valuations, and then swapped for less well understood, often cash draining, new businesses purchased at very high valuations. With digital critical mass now achieved, we think there is reduced motivation for portfolio changes.

Wolters Kluwer seems to have reached critical mass and is now able to enjoy the benefits of providing digital content relative to print. These benefits include much reduced working capital needs and production costs, ease of new product development, enriched customer functionality and opportunities for engagement and product cross sell, and, most importantly, scalability to new markets.

The performance trends chart on the previous page illustrates the clear positive trend over the last two years, showing that increasing organic sales levels are supporting gradual increases in earnings and return on capital.

A beneficiary of an increasingly complex world

Like their founding Dutch entrepreneurs, Wolters Kluwer is well placed to continue keeping its professional customers well informed, and to provide them with appropriate tools to navigate complexity and change. For these reasons, Wolters Kluwer is held in our funds with global exposure. UP

Investing for the future: Spire Healthcare

Aslam Dalvi - Associate Portfolio Manager

> The UK public healthcare system has come under increasing pressure in recent times. An ageing population coupled with increased fiscal constraints has led to lengthening hospital waiting lists and the need to shift patients from burdened public hospitals to the private sector. London-listed private hospital group, Spire Healthcare, has strategically invested in capacity ahead of this shift and stands out among its peers as optimally positioned to benefit.

Investing for the future: Spire Healthcare

Public healthcare systems globally

The World Health Organization (WHO) publishes a ranking of global healthcare systems based on a comprehensive study. It looks at expenditure, quality of care, access, efficiency and outcomes per dollar spent. According to the WHO, France is rated the number one healthcare system in the world. The rest of the top five are (perhaps surprisingly): Italy, San Marino, Andorra and Malta.

The United Kingdom ranks reasonably well in 18th place. The National Health Service (NHS) is the publicly funded national healthcare system responsible for arranging the provision of free health services at the point of care, including running hospitals and employing doctors. The public sector dominates UK health services. Government healthcare expenditure, which is funded via general taxation, accounts for around 80% of total healthcare expenditure. The UK spends around 9.6% of GDP on healthcare, marginally higher than the OECD member-country average.

The NHS is increasingly under pressure

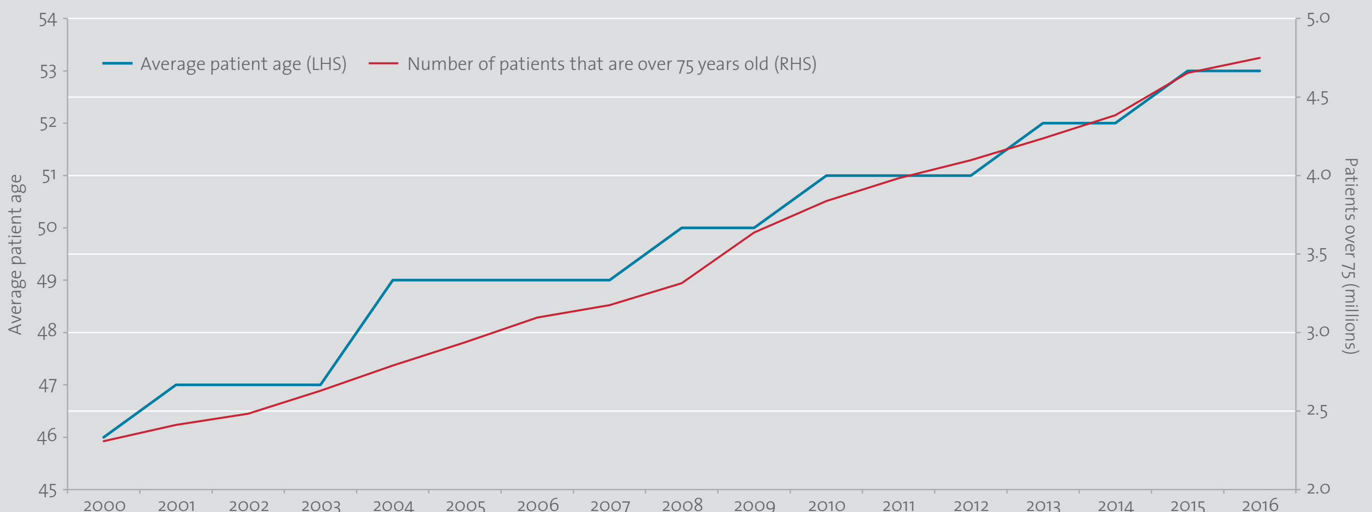
Despite relatively high spend, the NHS has come under increasing pressure due to a combination of demand growth and UK budgetary constraints. High healthcare inflation, low economic growth and an ageing population have led to funding challenges at the NHS. Patient admissions have grown at 3% to 4% per annum over the last decade while limited investment in new capacity has put significant strain on NHS resources. Overnight occupancy is currently more than 91% with little room for further growth and waiting times for procedures are at record highs and lengthening. The financial viability of the system is consequently at risk (graph opposite) with more than 65% of NHS trusts[1] in deficit and unable to meet the growing demand for healthcare.

Demographic trends for the UK are a concern with over a quarter of the UK population likely to be over age 65 by 2050, up from 18% currently. Healthcare costs increase significantly for ages over 65 and this increase in the older population will exert substantial pressure on the public sector in future years. The UK's Office of Budget Responsibility expects that overall health spend will have to rise by 6% per person per annum just to keep up with this demographically generated demand.

In 2014, the NHS was given a mandate to reduce spend in real terms over future years, recognising that there are simply not enough financial resources to meet current and expected future demand. The net result will be a further rationing of healthcare services, growing waiting lists and a shift of patients to the private sector.

[1] Trusts are the regional executing branches of the NHS, providing ambulatory, hospital and mental health services in different areas.

NHS patient population ageing



Source: NHS Digital

The role of the private sector

Against this backdrop of rising demand, increasing healthcare spend, lengthening waiting lists and growing budgetary constraints, private sector hospitals stand out as a key solution to the capacity problem. Structural pressure around funding will force the NHS to use the lowest cost and most efficient providers of care, shifting more volumes to the private sector over time.

Total NHS outsourcing to the private sector has grown by a compound annual growth rate of 15% over the last nine years, from 2.9% to 7.6% of total NHS services. Only a fraction of this outsourcing is acute care requiring treatment at a private hospital, but growth has been equally impressive within this segment going from £250 million in 2004 to £1.6 billion in 2016. Despite this explosive growth, only 6% of all NHS-funded admissions are treated at private hospitals. Accordingly, a small shift from the public sector to the private sector will provide a substantial boost to revenues for private players.

Spire Healthcare

Spire is the largest private hospital group in the UK with 38 acute care facilities, 12 clinics and two specialist care centres. The group listed on the London Stock Exchange in 2014 and South Africa's Mediclinic acquired a 29.9% stake in 2015.

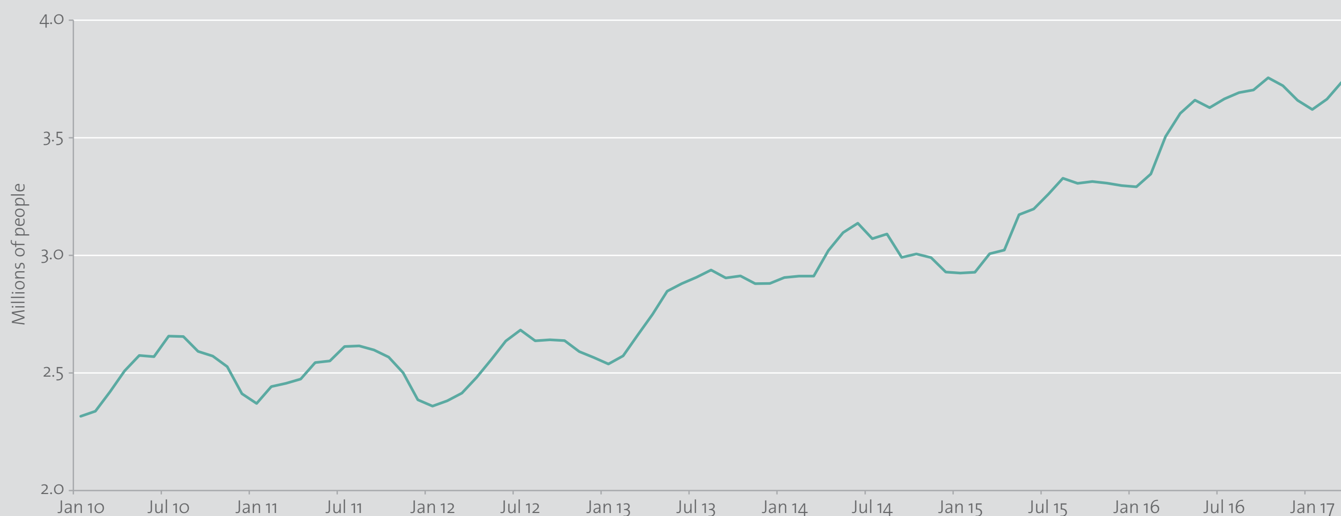
The group has delivered solid growth over the last five years and has consistently taken market share from competitors. This reflects a consistent investment in existing and new facilities, top class management and underinvestment by its largest competitor, BMI Healthcare (owned by locally-listed Netcare and previously the largest player in the UK). BMI's ability to invest remains heavily constrained by its operating structure, which encompasses high rental costs and a large debt burden. This structural weakness of a large competitor should allow Spire to continue gaining share over the medium term.

Well-positioned for growth

In 2014, Spire began a programme of investment, adding three new hospitals, 14 new theatres and a specialist oncology laboratory in the space of four years. The new hospitals are situated within large catchment areas, namely Manchester, Nottingham and Surrey and position Spire ahead of competitors to capitalise on NHS and private volume growth. Further expansion opportunities in London are currently being investigated. We view this investment programme as a key enabler of future growth, which we expect will start delivering returns over the next three years.

Around 32% of Spire's revenue is generated from NHS work. While NHS procedures are typically charged at a much lower

Growing number of people on NHS waiting lists



Source: NHS England; Referral to Treatment Waiting Times

Investing for the future: Spire Healthcare

tariff than private patients, the key opportunity for Spire comes from filling existing capacity as theatre occupancy (at 64%) remains very low. The benefit of NHS work in particular is that it is mostly elective. This allows Spire to precisely schedule procedures to fill vacant slots and thereby increase occupancy levels. Given the high fixed cost nature of a hospital, the incremental cost of performing an additional procedure is low, resulting in good profit growth, notwithstanding the lower price per procedure.

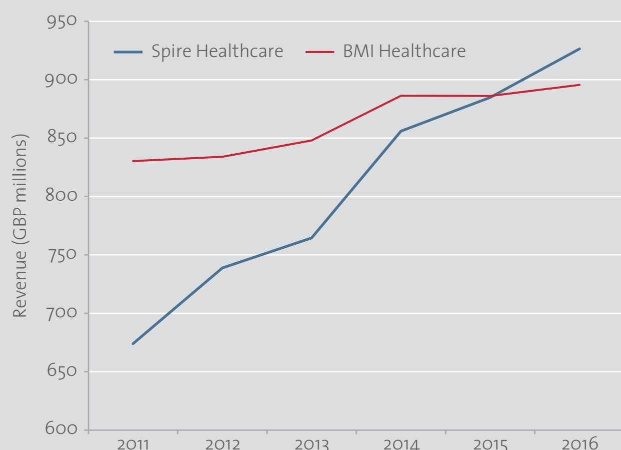
An ongoing challenge faced by the UK private healthcare market has been the decline in private medical insurance (PMI) members. Data from healthcare research provider, LaingBuisson, highlights that the overall PMI market has declined by 7.5% since 2008. This has had a large negative impact on Spire as PMI patients pay a higher rate per procedure and are twice as profitable relative to a typical NHS patient. Following the recent strength in the UK formal job market, we expect PMI volumes to stabilise and eventually grow again. Spire can shift its mix towards PMI patients relatively quickly and any recovery in the PMI market will therefore be very positive for future profit growth.

While PMI cases have been in decline, self-pay cases (where patients pay for treatment themselves) have been rising, though off a smaller base. This trend is likely to continue as the challenges at the NHS intensify – many of these patients are older and therefore longer waiting times (sometimes as long as 18 weeks) have a significant impact on both quality of life and recovery. This represents a further substantial opportunity for Spire Healthcare.

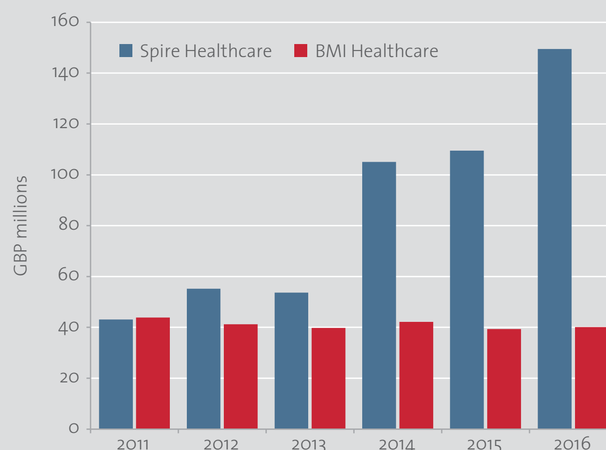
Outlook

Spire Healthcare stands out as having a younger, higher quality portfolio of hospitals versus competitors' and excellent clinical outcomes. The group has strategically positioned itself ahead of its competitors to take advantage of the increasing reliance on private healthcare facilities to deliver growth over the medium term. Spire Healthcare is a core holding in our funds with global exposure and investors should benefit from their ongoing growth. UP

Spire's growth has outpaced its closest competitor



Spire's higher capital expenditure



Source: Spire and Netcare company reports

Kagiso Asset Management Funds

Performance to 30 June 2017	1 year	3 years[1]	5 years[1]	10 years[1]	Since launch[1]	Launch	TER[2]	TC[3]
Unit trust funds[4]								
Equity Alpha Fund	7.3%	2.7%	10.5%	9.5%	17.6%	Apr-04	1.58%	0.36%
SA Equity General funds mean	-1.1%	1.8%	9.6%	7.4%	13.9%			
Outperformance	8.4%	0.9%	0.9%	2.1%	3.7%			
Balanced Fund	8.2%	4.9%	9.9%	-	9.6%	May-11	1.54%	0.39%
SA Multi Asset High Equity funds mean	1.5%	4.7%	9.8%		9.3%			
Outperformance	6.7%	0.2%	0.1%		0.3%			
Protector Fund	12.5%	6.0%	8.5%	7.0%	10.2%	Dec-02	1.63%	0.26%
CPI + 5%[5]	10.2%	10.4%	10.6%	11.2%	10.7%			
Outperformance	2.3%	-4.4%	-2.1%	-4.2%	-0.5%			
Stable Fund	8.3%	6.8%	8.8%	-	8.5%	May-11	1.55%	0.49%
Return on large deposits*	6.4%	5.9%	5.6%		5.6%			
Outperformance	1.9%	0.9%	3.2%		2.9%			
Institutional funds[6]								
Managed Equity Fund (SWIX)	4.0%	0.8%	9.9%	9.6%	11.9%	Sep-06		
FTSE/JSE SWIX All Share Index	0.3%	4.8%	12.9%	10.3%	12.5%			
Outperformance	3.7%	-4.0%	-3.0%	-0.7%	-0.6%			
Managed Equity Fund (Capped SWIX)	-	-	-	-	4.7%	Jan-17		
FTSE/JSE Capped SWIX Index					1.4%			
Outperformance					3.3%			
Domestic Balanced Fund[7]	6.9%	2.8%	8.1%	-	8.5%	May-07		
Peer median[8]	4.8%	5.1%	10.6%		9.8%			
Outperformance	2.1%	-2.3%	-2.5%		-1.3%			
Global Balanced Fund[9]	10.0%	5.9%	-	-	10.0%	Jul-13		
Peer median[10]	3.6%	6.1%			10.2%			
Outperformance	6.4%	-0.2%			-0.2%			
Sharia unit trust funds[4]								
Islamic Equity Fund	9.0%	2.8%	9.6%	-	11.7%	Jul-09	1.41%	0.23%
SA Equity General funds mean	-1.1%	1.8%	9.6%		12.1%			
Outperformance	10.1%	1.0%	0.0%		-0.4%			
Islamic Balanced Fund	6.2%	3.1%	8.6%	-	6.9%	May-11	1.48%	0.17%
SA Multi Asset High Equity funds mean	1.5%	4.7%	9.8%		9.3%			
Outperformance	4.7%	-1.6%	-1.2%		-2.4%			

Highest and lowest monthly fund performance	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest
Equity Alpha Fund	4.8%	-4.1%	8.2%	-4.7%	8.2%	-4.7%	10.9%	-9.0%	11.9%	-9.0%
Balanced Fund	3.1%	-3.5%	5.5%	-4.2%	6.2%	-4.2%	-	-	6.2%	-4.2%
Protector Fund	2.6%	-2.4%	3.4%	-4.2%	4.8%	-4.2%	7.9%	-5.3%	9.5%	-5.3%
Stable Fund	2.2%	-0.8%	3.8%	-3.5%	4.0%	-3.5%	-	-	4.0%	-3.5%
Islamic Equity Fund	3.9%	-3.2%	7.3%	-4.6%	8.1%	-4.9%	-	-	8.1%	-4.9%
Islamic Balanced Fund	2.4%	-2.1%	4.6%	-3.0%	8.2%	-5.4%	-	-	8.6%	-5.4%

[1] Annualised (ie the average annual return over the given time period); [2] TER (total expense ratio) = % of average NAV of portfolio incurred as charges, levies and fees in the management of the portfolio for the rolling three-year period to 30 June 2017; [3] Transaction costs (TC) are unavoidable costs incurred in administering the financial products offered by Kagiso Collective Investments and impact financial product returns. It should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of financial product, the investment decisions of the investment manager and the TER. This is also calculated on the rolling three-year period to 30 June 2017; [4] Source: Morningstar; net of all costs incurred within the fund and measured using NAV prices with income distributions reinvested; [5] CPI for June is an estimate; [6] Source: Kagiso Asset Management; gross of management fees; [7] Domestic Balanced Fund benchmark returns are an estimate for June; [8] Median return of Alexander Forbes SA Manager Watch: BIV Survey; [9] Global Balanced Fund benchmark returns are an estimate for June; [10] Median return of Alexander Forbes Global Large Manager Watch. *Return on deposits of R5 million plus 2% (on an after-tax basis at an assumed 25% tax rate).

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