INVESTMENT ANALYSIS OF THE U.K. HEALTH SECTOR

The Analysis of four companies in the U.K. Health Sector in order to determine if there are reasons other than an ageing population which would make investments attractive.

Community Hospitals Group Plc.

Nestor Healthcare Group Plc.

Nycomed Amersham Plc.

SSL International Plc.

Submitted by Peter Ritzow to the University of Exeter as a dissertation towards the degree of Masters of Arts by advanced study in Finance and Investment, May 2001.

SCHOOL OF BUSINESS AND ECONOMICS

I certify that all material in this dissertation which is not my own work has been identified and that no material is included for which a degree has previously been conferred upon me. $\bigcap \qquad \bigcap \qquad \bigcap \qquad \bigcap$

Abstract

Following the dramatic rise and the devastating, yet inevitable, correction of share-prices for Technology- and Internet stocks on all international stock markets in the year 2000, investors are returning to value companies in the 'Old Economy'. However, the currently weak economic situation world-wide demands careful consideration and analysis of market places, sectors and positioning of the individual companies. The United Kingdom, with its traditionally low beta stock market, offers a variety of comparatively safe investment opportunities. In particular, the UK non-cyclical Health sector appears attractive in a market place, where falling interest rates and low inflationary pressure are mirroring an economic slowdown.

The Health sector is usually perceived to have its greatest growth opportunity in an ageing population. However, there are numerous other external influences, which could benefit companies in this sector enormously. A growing market size, the government's attempt to restore confidence in the NHS and a variety of social trends are potentially high growth drivers.

The rationale behind the selection of the four companies lies in the diversity of the UK Health sector. A recruitment company, a hospitals group, an over-the-counter producer and a biotechnology company were chosen in order to outline the different activities pursued in this sector.

The purpose of the following chapters is to describe the external and internal environment of these four diverse representatives of the UK Health sector and to analyse whether these companies are sufficiently well positioned to profit from highly advantageous external influences. Complementing this fundamental analysis will be a brief technical analysis for each of the selected companies.

Acknowledgements

This dissertation, and in fact the entire Masters Programme, would not have been possible without the assistance of a large number of people. Space does not permit me to name them all, but I am nevertheless extremely grateful to them, one and all. However, there are five lecturers, staff members and course mates from the University of Exeter School of Business and Economics for whose support, ideas and comments I would like to give special thanks: Mr. Ivan Cottrell, Mr. Richard Purkis, Mrs. Kay Beales, Dr. John Maloney and Maxim Valentinovitch Shepelev.

I would also like to use this opportunity to thank my parents, Dr. med. Ellen Ritzow and Priv.- Doz. Dr. med. habil. Henning Ritzow, for their generous support, encouragement and parental love throughout my entire academic career.

Finally, and most importantly, I am irredeemably indebted to Ariane Zegarra and Simon Lewis, whose motivational efforts seem to have worked.

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Chapter 1

Economic Environment

1.1 UK- fundamentally strong considering...

Following a sharp slowdown in real GDP growth in Q4, the Bank of England responded to signs of slower economic growth in the US and Europe by cutting interest rates to 5.75 per cent and again by a cumulative 50 base points in April and May.

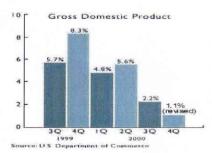
With growth of just 0.3 per cent, first-quarter figures of UK GDP growth were disappointingly weak and 0.1 per cent less than predicted. This slowdown was mainly caused by a considerable weakness on the industrial side as sectors with strong international links were adversely influenced by a slowdown in the world economy. However, the 2001 Budget announcement of cutting net taxes by £3.6bn in 2001/02, and £4.9bn in 2003/04 is highly promising.

Given the latest updates on GDP growth forecasts, the UK is unlikely to experience a larger downward revision of the base rate from its current 5.5 per cent level. Growth forecasts for 2001 and 2002 are ranging between 2.4 per cent for 2001 and 2.75 per cent for 2002. Considering that the overall world economy was hit hard by the sharp slowdown in the US economy, the latest UK figures do not appear too gloomy.

Although inflation forecasts for 2002 are at 2.5% considerably higher than the 2001 forecasts of 1.7%, the last 25 base point cut in May 2001 was essential to bring back momentum on production side.

1.2 US- Bottom reached

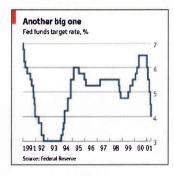
Towards the last two quarters of 2000, concerns about a slowing economy were sparked



by weaker production, employment, wages, and price data. As a result, the Fed cut interest rates unexpectedly and forcefully by 50 base points in January and in April 2001, leaving the key US lending rate 2 percentage points lower at 4.5%.

However, evidence suggests that the US economy has started to recover already. As published by the US Commerce Department on 27th April, Q1 2001 figures showed that the US economy is growing to an unexpectedly strong annual rate of 2 per cent. These figures followed a five-year growth low of 1 per cent in the final three months of 2000 and give reason to believe that the downturn of the most influential economic power has come to a halt.

In fact, figures also revealed that demand in the US economy is still remarkably strong. Although growth was adversely affected by falling investments, caused by a sharp rundown in inventories, growth in consumer spending, which accounts for two-thirds of the economy, accelerated. Spending on housing, cars and other durable goods was particularly strong, as consumers were taking advantage of low borrowing costs.



The Fed cut interest rates by another 50 base points in May 2001, leaving the current interest rate level at 4 per cent. Given the release of figures for the first quarter 2001, the Fed is unlikely to engage in further sharp interest rate cuts, especially in the light of evidence that inflation is picking up slightly. As a result, Fed funds future prices decreased

significantly, reflecting expectations of stable or marginally falling interest rates.

1.3 Europe- Lack of Confidence in ECB

Unexpectedly sharp price rises in Germany and Italy resulted in an annualised Eurozone inflation of 2.8 per cent in April 2001 (2.6% in March 2001). Hence, it is more than likely that the annual inflation target of 2 per cent will be overshot for the second consecutive year. Nevertheless, the slowdown in GDP growth in many EU countries forced the European Central Bank to cut interest rates by 25 base points in May 2001.

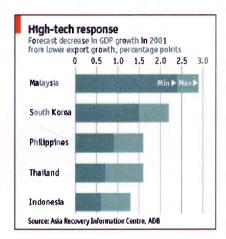
The most influential driver of this interest rate dilemma is Germany, where growth forecast were revised down from 2.75 per cent to about 2 per cent this year. In contrast, France reported growth forecasts of 2.9 per cent for 2001. This demonstrates that even the strongest members of the Union are still very much out of sync.

Since the Euro's introduction in 1999, the strongest inflation drivers have been relatively high crude oil prices and the weakness of the Euro. Neither of these factors have released inflationary pressures yet. In fact, though the ECB raised interest rates by

a cumulative 1.75 percentage points between November 1999 and October 2000, the Euro's weakness wiped out much of that tightening. The ECB's main interest rate stands at 4.5 per cent until inflationary pressures are starting to ease.

1.4 Asia(ex Japan)- Fragile Economic Situation

As the US accounted for 1/4 of Asia's growth in 2000, it is no surprise that Asian



exports, and hence Asian GDP growth slowed as US economy went into recession. In addition to the export slowdown, weak domestic demand endangers the region's recovery prospects. Adding to the problems are the region's banks, which are still confronted with bad loans and are reluctant to lend to local companies. GDP growth rates are expected to halve this year, which will ultimately hinder political and economic restructuring. The Philippines, Indonesia, Malaysia

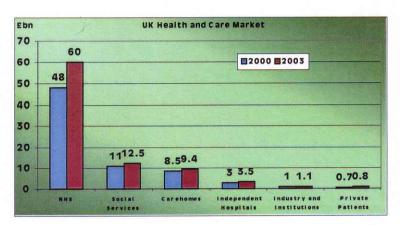
and Thailand will grow by 2.7% on average in 2001 while the four 'Tiger' economies (HK, Taiwan, Korea, Singapore) will grow by about 4% on average.

Chapter 2

The External Healthcare Environment In the U.K.

The total value of the UK healthcare market is currently standing at GBP 72bn and is estimated to grow by 21% over the next three years to approximately GBP 87bn. This is illustrated in the following graph, which shows the nominal share of individual institutions or interest groups of the total UK Health market in 2000 and 2003. At an

increase of 25% over the next three years, the NHS will have caused most of this value increase, followed by Independent Hospitals (+17%), Social Services (+14%) and Private Patients (+14.3%).



2.1 General Economic Statistics

2.1.1 Statistics of the Individual Markets

NHS Market:

- > established in 1948
- > provides a service available to the entire population, free at the point of delivery
- > 589 primary care structures, 123 Health Authorities, 404 NHS Trusts
- NHS Agenda 1 till 2004: Budget increase by 25%
- NHS Agenda 2 till 2004: Increase staff by 7,500 consultants, 2000 GPs and 20,000 nurses
- NHS Agenda 3 till 2004: Better Service Quality and Shorter Waiting Lists

Social Service Market:

- > 205 Social Service Departments
- ➤ GBP11bn UK total allocations
- Market size of elderly community care GBP2.4bn
- ➤ GBP520m worth of market size purchased by government from independent sector
- ➤ 140m Homecare hours provided in England every year
- > 424,000 households served
- > Between 1992-1999 hours provided by independent sector increased from 2% to 51%
- > Trend towards joint health and social care (Government White Paper 1998)

Care Homes Market:

- > Residential and Nursing Homes
- > Total UK market value: GBP8.5bn of which GBP5.4bn is covered by the private sector
- > 28,500 homes across all sectors
- > 540,000 places across all sectors

Independent Hospitals Market:

- > Total UK market value is GBP3bn
- > 105% growth in acute medical treatment spending between 1990 and 2000
- > 225 Independent acute hospitals
- bed capacity around 10,000
- > 86 NHS private patient trusts with 1,400 beds
- ▶ Beds and Hospitals quantity increased by 50% over the last 20 years

Private Patient Market:

- ➤ GBP 462m spent on Private Homecare
- ➤ GBP 222m were spent on Home Adaptations
- > 3,000 Private Domiciliary Care Providers
- ➤ 500 Registered Nursing Care Agencies

2.1.2 Members of the FTSE All Share Health Sector

At about 30 per cent the sector's greatest weight in terms of market capitalisation is represented by Nycomed Amersham. This comes as no surprise as this company is also a member of the FTSE 100. The other three companies are somewhat less important in terms of sector and therefore deserve a smaller weight. SSL International occupies the 200th position in the FTSE Mid 250 and is therefore more important to the All Share Health Sector than Community Hospitals Group and Nestor Healthcare, which are included in the FTSE SmallCap.

2.2 Political Factors

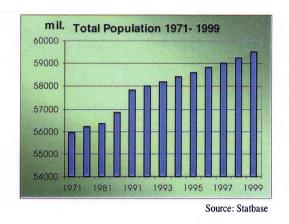
As Britain is currently preparing for General Election, it comes as no surprise that political parties throw in their last resources in order to gain voters' support. Education, Social Welfare but also the provision of medical services is high up on the political agenda. Although it is recognised as one of the best health services in the world by the World Health Organisation, improvements to cope with the demands of the 21st century are desperately needed. Long waiting lists, an overworked and ageing nurse-population and a perceived lack of competence all contribute to a continuing downfall of operational performance and consumer confidence. Having realised aids and grants alone are not able to reverse this trend, the government is now approaching the problem by closely co-operating with the private sector. This concordat between the public and private sector works both ways. The public sector gains through the reduction of the patient-overload, allowing time for re-construction and improvements of working conditions. At the same time, patient activity and turnover increases in the private sector as former NHS patients are now treated in private institutions.

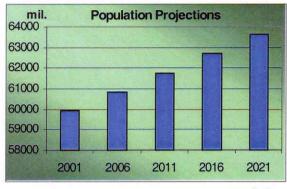
The effects of this mutually beneficial agreement are enhanced through a generous consideration of the NHS in the Budget 2001. Here the Treasury allocated an extra £1 billion to the NHS over the next five years in an attempt to restore treatment quality and confidence. The total budget increase will then amount to £6.7bn in 2003/4. This money is used to build an additional one hundred hospitals with an estimated total of 7000 beds; to employ some 30,000 extra nurses, consultants and GPs; and to shorten waiting times for hospital and doctor appointments. Around £450m are allocated for extra equipment, such as scanners and X-rays.

The increase in patient activity in the private sector associated with this transitional stage of NHS-restoration is more than just a short- or medium term phenomenon. The 2001 budget considerations are merely sufficient to accommodate for current problems. However, demographic developments in the UK signal a far greater demand for Healthcare services in the next 10 years and beyond. With an ageing and increasingly unhealthy population, the private sector will not only be faced with a genuine increase in their own patient activity but will also have to continue clearing NHS-backlogs.

2.3 Social Factors

The analysis of social factors influencing the Health sector reveals the main external driver for growth, namely the increase in patient volume. As the British population is undergoing change in terms of both demographics and lifestyle, the sector will benefit from a bigger, older, less healthy and more disease-prone population.

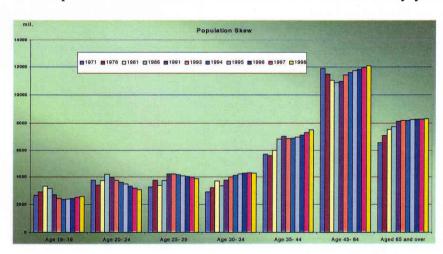




source: Statbase

2.3.1 Ageing Population

There can be no doubt about the British population becoming older. The population-age development of both females and males over the last thirty years is characterised by a



steady increase in the age groups '35-44', '45-64' and '65 and over' since the early 1990s. At the same time the younger age groups of '20-24' and '25-29' are experiencing

a fall in numbers. Population projections for the next fifty years show that the group '60 and over' will explode from its current level of 12,000,000 to nearly 19,000,000 by 2051. What does this development indicate for the Health sector?

First, the older the population becomes, the higher the quantity of patients demanding treatment will be. The proportion of people with at least one long standing illness was up from 40% to 44% between 1993 and 1999 for both men and women. Age-related illnesses, such as Alzheimer's disease, are contributing towards this volume increase just as much as psychological problems of ageing. Depression, loneliness and confusion among the elderly are enhanced further by a break—up of their micro-environment. The

closure of rural post offices and bank branches more often leaves the GP as the only port of call if an old person just needs to talk to someone. Clearly, alternatives must be and are being found in order to take weight of the strained organisational and operational structure of the National Health Service. These patients are now being channelled to more appropriate, highly specialised institutions.

Secondly, technological advances are synonymous with a higher rate of patients revisiting their GPs. In other words, as the quality and effectiveness of treatment improves, life expectancy is increasing. As a result, the population will be represented by a growing number of older people, demanding *more intensive* physical and psychological care *for a longer period of time*. This trend was realised by the private sector some time ago and facilities such as home care, nursing homes and remote monitoring are being put in place in order to take advantage of this development.

Thirdly, cost for health provision is rising. The 85+ age group is estimated to increase from 1.1 million to 3 million by 2056. The cost per capita of providing health services to the 85+ group is more than four times higher than the cost of providing services to 45-64 year olds. Hence, highly specialised healthcare institutions are required to profit from this trend through the exploitation of economies of scale and synergy effects thereby keeping costs to a minimum.

The rise in proportion of people over 65 associated with changing population demographics, results in a higher population proportion suffering debilitating chronic disease. Here, earlier diagnosis will have substantial economic benefits to healthcare providers while at the same time the patient's quality of life is significantly improved.

2.3.2 Change in Lifestyle

Adding to the problems caused by an ageing population is the change in lifestyle, which is resulting in a generally unhealthy core-population. Our more career, less family-oriented society has two broad implications on the development of health service provision. On one hand, the highly competitive job market demands permanent top performance on behalf of the employee. In order to compensate for the stress experienced at the workplace, more convenience in private life is demanded. Fast-food, lack of physical exercise and the abuse of alcohol and drugs are notorious companions

of this professional workload increase. Between 1994 and 1999, obesity increased from 58% to 63% for men and from 49% to 54% for women.

On the other hand, this career-orientation is preventing the start of families. Not only are there more singles than forty years ago, but also couples are dragging out pregnancies in fear of losing their jobs. Other problems associated with the lower willingness to be tied up in a relationship is the rise in sexually transmitted diseases. Contradicting the general belief that HIV infections are falling, national statistics show that a false sense of security caused by the medical advances (the break-out of AIDS can be delayed significantly by a cocktail of drugs) has led to a higher HIV infection rate among the heterosexual community over the last two years. Other, rapidly spreading and potentially sterilising STDs, such as Gonorrhoea and Chlamydia, are also associated with the reluctance to use condoms and are adversely influencing family plans.

The emphasis on careers also means that individuals are left with higher disposable incomes, enabling them to take advantage of private medical treatment. Thus, while the outlined health issues are disadvantageous for society as a whole, they are very welcomed by the private medical sector. In other words, the sector has enormous growth potential as the population becomes older, unhealthier and wealthier.

2.4 Technological Factors

Technological advances in the past decade have re-shaped the health sector tremendously. These advances are ranging from improvements in the way illnesses are diagnosed, treated, and managed to the immunisation of the human body against diseases through genetic modification.

2.4.1 The Disclosure of the Human Genome

In February 2001, the disclosure and publication of the 'book of life', the human genome, revealed that fewer genes than expected make up the genetic code. The DNA from two unrelated individuals is on average 99.9% identical and that human DNA is insignificantly different to that of other mammals, such as mice. These key findings have dramatic consequences for medicine and health. Theoretically, disease-resistant genes can be extracted from a mouse, replicated in test-tubes and inserted into any human being, who will then not only be able to carry this resistance-characteristic, but will also be able to pass it on to future generations. While at present ethical reasons do

not allow the modification of the human genetic code on a broad, commercial scale, the information which is now being accumulated will provide scientists with the ability to apply existing medicines better and to develop new cures.

2.4.2 Outsourcing

The remedy for adverse demographic developments is to outsource long-stay, chronic patients in order to make way for acute treatments. Innovative technology allows to shorten the duration of operations as well as the subsequent hospital stay. Keyhole-surgery is widely used in the medical sector. However, its full advantage can only be witnessed in the private sector. Unlike the NHS, where hospitals tend to maximise costs so that their budget share will not be cut in subsequent years, the private sector has to act as efficiently as possible in order to make medical treatment affordable. For example, a straightforward Arthroscopy takes four hours (including recovery) in a private environment and costs approximately £1,700. The patient is able to leave the operating facilities on the same day and recover at home. In contrast, the NHS keeps patients for several days under medial supervision. This unnecessary procedure cost the patient up to three times as much as identical private treatment.

As an alternative to the unsupervised post-operational recovery, technology allows, in form of remote medical treatment, overworked GPs to check up on their patients via the Internet. Here, the patient's biodata are permanently monitored while he is recovering at home.

Chapter 3

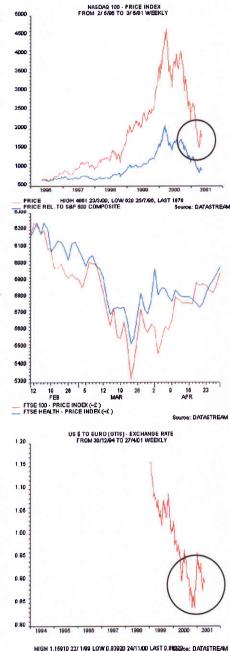
Stock Market Conditions

The world stock market situation is heavily influenced by the developments in the United States. After a dismal performance of the NASDAQ in 2000, the upward

revision of US GDP growth in the first quarter of 2001 caused the return of confidence in the US stock market and indeed in the NASDAQ, too. The recovery of the US has had knock-on effects on the rest of the world. Consequently, all European Stock Markets including the FTSE have gained momentum over the past five weeks.

The development in the world's most significant market places also had spillover effects on the individual sectors. The UK Health sector was able to gain around 9 per cent, or 500 points (rebased), over the past weeks, a similar rate to that of the FTSE 100. In the short- and medium term, this growth rate of the recovery phase may, however, not be sustainable and a sideways trend is more than likely for the next six months.

The development of the Euro vis-à-vis the US Dollar in the past six months was characterised by a steep recovery, which was followed by a sharp decline. The current Euro level of around USD0.88 is not expected to change drastically, as worries over the transparency of policy making at the European Central Bank cause confidence to in the common European currency to fall.





(Bloomberg: CHP; Datastream: CHG)

HOLD

UK Equity Analysis
Healthcare Sector

Current Price: 657.5p

52 week high:

677.5p

52 week low:

487.5p

Market Capitalisation:

£234.1m

Index :

FTSE SmallCap

- ➤ Government influence ensures higher patient volume
- ➤ Strong underlying business performance, with EPS of 44.2p by 2002
- Acquisition in the final stage with current price approximately equal to price paid by Capio
- Rather than buying shares in CHG, buy shares in strong Swedish Hospitals Group, Capio. Their fundamentals are strong and earnings forecasts would have to be revised upwards, given CHG's contribution.

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Key Data				
	2000	2001	2002	
Norm Pretax (m)	19.3	20.9	23.1	
Norm EPS (p)	40.6	40.1	44.2	
DPS (p)	16.2	17.8	19.5	Hall book
DY (%)	2.67	2.92	3.21	
Norm PER (x)	15	15.2	13.7	
Next AR year end		30/06/0		

Chapter 4 Investment Analysis Community Hospitals Group Plc



4.1 General

Community Hospitals Group Plc is the fourth largest UK private hospital group, providing independent healthcare services to a number of communities in England.

After the sale of Company Health Limited in 1996, which provided on-site health services to the business community, CHG's primary strategic target is acute care service. Currently, the group is operating 21 hospitals with 24-hour Medical Officer cover and a full range of modern diagnostic equipment. The healthcare services it offers include home-care, funding and healthcare management, with 48 operating theatres, 21 fully equipped X-ray suites and 862 hospital beds ensuring a smooth running of the group's day-to-day operations.

4.2 Cyclicality

CHG is included in the non-cyclical UK Health Sector. This categorisation is justifiable to the extent that people require medical care no matter whether the economy is in an up- or downturn. However, an increasing part of CHG's turnover growth has come from self- paying private patients. For consumers like these, healthcare is a luxury product, whose demand is greatly dependent upon economic cycles. Thus, a company like CHG with a rising proportion of 'cyclical' consumers will suffer proportionally more from an economic slowdown than a purely insurance-based hospital.

4.3 Acquisition Talks

Numerous attempts have been made to acquire the majority of issued ordinary shares of CHG in the last 12 months.

In April 2000, British United Provident Association (BUPA) made a 620 pence per CHG share all-cash offer, which was equivalent to a 111% premium on the share price. However, the UK Secretary of State for Trade and Industry referred the proposed purchase to antitrust regulators and BUPA's offer lapsed. The proposed acquisition of CHG by BUPA raised competition concerns in respect of both the private medical insurance and private medical services markets in the UK.

In January 2001, General Healthcare Group (GHG), the UK's largest private hospital owner, was seeking clearance to make an offer for CHG. Similarly to BUPA's attempt, this has also been referred to UK regulators because of concerns that the group would control too much of the country's private health care.

CHG's board is continuing to evaluate several approaches and strategic options, stressing that the prospects of an independent CHG are highly encouraging. Potential suitors are believed to include the US groups HCA Columbia and the United Surgical Partners. However, the most promising offer for CHG has been made by Capio, a Swedish hospitals provider. Their latest offer from 26th April 2001 values Community Hospitals at £244m and is currently being evaluated by the board and the UK competition commission.

4.4 Competitors

Although there are numerous smaller hospitals and a few bigger ones, CHG is not subject to major competitive pressure, especially with the concordat between NHS and private sector. On the contrary, growth constraints led the company to put itself up for sale since April 2000. Another British Hospital group, Health Clinic, is also represented in the UK Health Sector.

4.5 Strategy

The company's objective is the based around creating long-term shareholder value through organic growth. Focusing on quality-healthcare, while at the same time taking advantage of synergies and economies of scale, fulfils this. In other words, every hospital is sufficiently flexible to take advantage of local opportunities while at the same time exploiting the buying power the group possesses on an overall level.

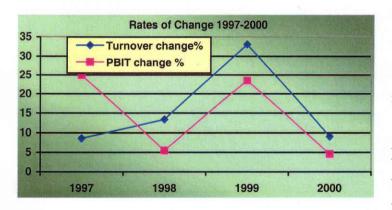
The quality focus is reflected and ensured by the recruitment and training of high-quality staff. CHG's retention rate is greater than the industry average, as offering higher than average wages ensures staff-loyalty. The group is also able to pride itself with a management team, which is on the constant lookout for enhancing in-group efficiency as well as taking advantage of new opportunities. Creating alliances with NHS and private insurers and investing in growth markets such as outpatient activities are just two examples how management puts these growth ideas into practice.

CHG is currently looking for a strong partner in the health sector, who will either provide the company with patient volume (BUPA) or put it in a position with even more buying power (GHG).

4.6 Turnover and Profit Analysis

in £m	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Interim-00	Interim-01
Turnover	69.6	75.5	85.6	113.9	123.9	57.7	66.9
Change	n/a	8.47%	13.31%	33.11%	8.78 %	n/a	15.94%
PBIT	13.3	16.6	17.5	21.6	22.5	8.9	10.7
Change	n/a	24.81 %	5.42 %	23.43 %	4.63 %	n/a	20.2%
							Source: Datastrear

Over the last five years, turnover has seen an increase of more than 60% caused by



strong growth in the number of self-pay patients in addition to growth in private medical insurance patients.

Patient activity and subsequent turnover growth is expected to become even stronger over the

foreseeable future due to a variety of reasons. First, CHG will continue positive dialogue with private medical insurers, such as BUPA, PPP and Standard Life Healthcare (SLH). Here, fundamental issues concerning pricing, pre-authorisation of claims, electronic data interchange and payment terms are being discussed, in order to reduce administration cost and speed up the average time of treatment per patient. This will enable CHG to deal with more patients, *per annum*, given capacity constraints.

Secondly, following an attempt by the government to channel patients from the NHS to the private sector, patient activity from the public sector has risen to 5.1% in 2000. This Concordat between the NHS and private sector is expected to make up a double-digit percentage in CHG's patient portfolio in 2001.

Thirdly, Outpatients and Day case activities continue to be the fastest growing services with revenues accounting for 43.8% of total revenues.

Turnover is also set to increase as the group is investing £5.8m in the expansion of hospitals and in the provision of services to the elderly. Gardens Nursing Homes are designed to provide care for the physically disabled, chronically sick and frail elderly. The strategy of targeting this age group seems particularly promising given the demographic changes in British society as illustrated in the introductory chapters.

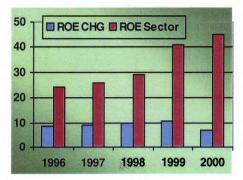
CHG was able to increase profits by roughly 57% from 1996 to 2000, achieving almost simultaneous turnover and profit growth over the last five years. The main factors responsible for this enormous achievement are CHG's management teams, who are renowned for taking advantage of opportunities in their local hospital environments while at the same time exploiting economies of scale arising from membership of group. Moreover, the company's performance has been supplemented by its three subsidiaries, which, according to the Directors, are material in achieving the group's objectives and strategy.

Interim Results for 2001 confirm continuous growth across all areas of the Group's business with turnover and profit rising by 16% and 20%, respectively.

4.7 Ratio Analysis

Performance Ratios

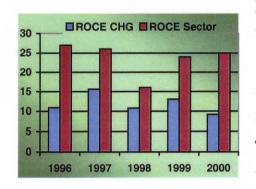
PROFITABILITY		Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Mean
ROCE (%)	CHG	10.87	15.84	10.83	12.77	9.21	11.90
	Sector	26.66	26.40	15.95	23.86	24.99	23.57
Margin (%)	CHG	19.13	19.78	19.88	18.88	18.37	19.21
	Sector	10.48	9.64	8.95	7.30	7.26	8.73
Tax Ratio (%)	CHG	30.95	29.29	33.09	31.3	24.23	29.77
	Sector	32.53	34.83	52.33	40.57	38.74	39.80
ROE (%)	CHG	8.53	9.16	10.04	10.5	6.79	9.00
	Sector	24.04	25.84	28.91	40.68	45.03	32.90
						Source	e: Datastream





Due to the diversity of companies included in the UK Health Sector the performance of individual companies may differ greatly from the sector benchmark.

CHG's ROCE has a five-year average of 11.9%, nearly half that of the sector. Responsible for this deviation is the nature of the group's business. CHG requires expensive medical equipment. For example, a fully equipped X-ray suite costs in excess of £1m with substantial maintenance costs per annum. Since depreciation reduces the book value of these assets and is charged against the income of CHG in their Profit and



Loss Account, the subsequent profit figures are bound to be lower.

At the same time, the tax burden is reduced as a lower profit before interest and tax is reported. This is reflected in a relatively low tax ratio, which has been 10% less for CHG over the last

five years compared to the sector average.

The low ROCE in 2000 is attributable to a substantial increase in value of hospitals. The latest five-year revaluation carried out on 30th June 2000 strengthened the denominator (capital employed figure) of the ROCE ratio and reduced the numerator (profit figure) due to higher depreciation. As a result, ROCE fell from 12.77% in 1999 to 9.21% in 2000.

At £14.69m, Profit after tax is more than 20% higher than the reported 1999 figure. Hence, one would expect ROE to have improved as well. However, the increase in CHG's revaluation reserve from £15.6m in 1999 to £90.7m in 2000 caused the *Total Shareholders' Funds* position in the firm's Balance Sheet to double. As a result ROE was reported to be 6.79% in 2000, significantly lower than the five-year average of 9%.

Although CHG's profit margin seems strong, especially when compared to the sector, creeping margin pressure over the past two years is evident. This is mainly attributable to industry-wide rising labour costs, over which the company has no control.

ACTIVITY		Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Mean
Activity (%)	CHG	0.57	0.8	0.54	0.68	0.5	0.62
	Sector	2.45	2.51	1.60	2.99	3.18	2.55
Stock Days	CHG	9.73	8.59	11.5	9.22	8.81	9.57
	Sector	47.97	47.14	81.16	44.8	39.89	52.19
Debtor Days	CHG	50.16	42.96	67.35	47.74	41.42	49.93
	Sector	72.23	71.18	124.26	71.01	68.94	81.53
Creditor Days	CHG	74.71	74.9	129.09	78.61	71.85	85.83
	Sector	68.37	69.87	133.67	73.38	66.53	82.36

With a relatively stable profit margin, the fall in ROCE is attributable to the fall of the activity ratio. Again, this is due to the revaluation of the firm's capital employed, rather than the result of the inability to utilise assets effectively. In fact, historical figures highlight the trend of a continuous underperformance with respect to the sector. However, this comes as no surprise as CHG's business nature is characterised by using capital intensive equipment to operate on human beings. Not only does this require time and care but also a relatively high capital employed position to generate sales. For example, a patient is receiving key-hole surgery. The medical equipment necessary is an endoscope, three nurses, one surgeon and one fully equipped operating theatre. It takes about three hours for the operation to be finished, in which time nobody else is able to use this equipment. The patient only pays about £1,500 for this operation. In other words, £500,000 worth of operating facilities produce on average only six units per day. Hence, the low activity ratio.

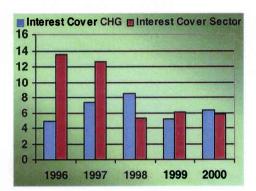
Since CHG's is a pure service provider, the only items remaining in stock for nine days on average are the inputs required to provide these services. Hence, the subsequent stock figure is rather low. It is also encouraging to see that the management was able to reduce the number of stock days in 2000, when the amount held in stock increased by nearly £100m. With asset management like this, liquidity problems are less likely.

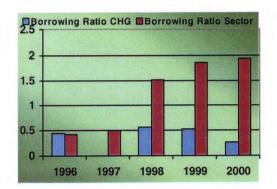
Similarly, the company takes less time collecting outstanding debts than repaying its short-term liabilities. However, in order to maintain good supplier relationships, creditor days have been reduced by seven days in 2000. Since debtor days have fallen by roughly the same amount, liquidity problems are being avoided.

Corporate Finance Ratios

	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Mean
CHG	4.94	7.38	8.51	5.17	6.26	6.45
Sector	13.5	12.65	5.27	6.03	5.82	8.65
CHG	0.44	0.01	0.57	0.53	0.27	0.36
Sector	0.43	0.5	1.52	1.87	1.95	1.25
	Sector CHG	CHG 4.94 Sector 13.5 CHG 0.44	CHG 4.94 7.38 Sector 13.5 12.65 CHG 0.44 0.01	CHG 4.94 7.38 8.51 Sector 13.5 12.65 5.27 CHG 0.44 0.01 0.57	CHG 4.94 7.38 8.51 5.17 Sector 13.5 12.65 5.27 6.03 CHG 0.44 0.01 0.57 0.53	CHG 4.94 7.38 8.51 5.17 6.26 Sector 13.5 12.65 5.27 6.03 5.82 CHG 0.44 0.01 0.57 0.53 0.27

Similar to profitability, the revaluation of the group has had its impact on solvency as well. The borrowing ratio is at 0.27 well below that of the sector. Again, this is not attributable to a real increase in *equity capital/reserves* or decrease in *debt*. Rather, it is the accounting adjustment that caused the borrowing ratio to be off course. However, even when ignoring the 2000 deviation, it is evident that this ratio has been considerably





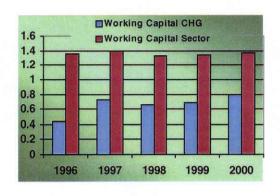
lower than the sector. This is attributable to the mostly debt-financed pharmaceutical and biotechnology companies, which push up the mean.

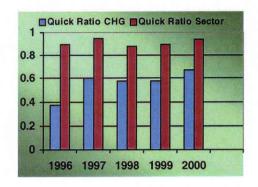
At an almost unchanged long-term loan requirement in 2000, the rise in interest cover is due to the five per cent increase in *Profit before Interest and Taxation*. As a result, the firm is reverting back to its medium term average interest cover figure of 6.45. Over the last five years, the sector has been experiencing a downward trend. At the same time CHG has been following an upward trend in interest cover, indicating that the group will be able to meet loan-maintenance charges more comfortably than the sector.

LIQUIDITY		Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Mean
Working Capital	CHG	0.44	0.72	0.66	0.69	0.79	0.66
	Sector	1.36	1.39	1.32	1.34	1.37	1.40
Quick Ratio	CHG	0.37	0.6	0.58	0.58	0.67	0.56
	Sector	0.9	0.95	0.88	0.90	0.94	1.1
						Source: I	Datastream

In terms of liquidity, Community Hospitals do not appear well positioned in comparison with the sector. Total current liabilities are greater than total current assets, resulting in a working capital ratio lower than one. However, active management of stocks, creditors

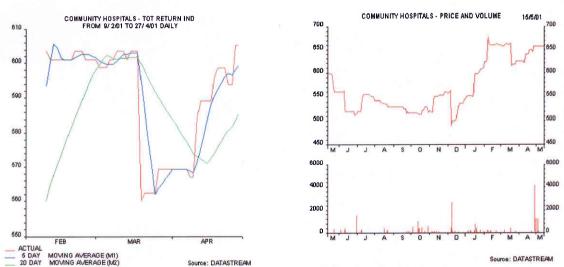
and debtors has improved these ratios and the threat of insolvency seems unlikely. The increasing trend of these liquidity ratios over the last two years confirms this.





4.8 Technical Analysis

The technical analysis reveals a crossover of short term and very short term moving averages. At 570p, the upward sloping five-day moving average crossed the twenty-day average. This was a clear purchasing sign. Since then, the twenty-average has changed



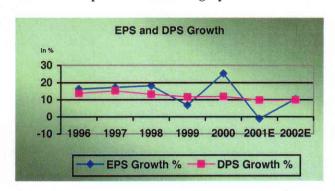
its slope and is currently in a steep upward trend. However, given relatively low interest in the CHG and subsequent low liquidity in the stock compared with larger cap companies, a technical analysis of the share price may not be conclusive and is of limited use.

4.9 Investors Ratios and Financial Forecast

Year to end Dec	norm Pre-tax Profit (m)	EPS (p)	CFPS (p)	DPS (p)	DIV. COVER (x)	DIV. Yield (%)	EV/EBITDA (x)
1999	17.2	32.4	52.2	14.5	2.24	n/a	29.03
2000	19.3	40.6	64	16.2	2.51	2.67	30.66
2001E	20.9	40.1	n/a	17.8	2.26	2.92	n/a
2002E	23.1	44.2	n/a	19.5	2.27	3.21	n/a

Source: Datastream

The development of earnings per share has been somewhat bumpy over the last five



years. After steady increases of 16 to 19 per cent per annum from 1996 to 1998, a more substantial increase of roughly 25 per cent was achieved in 2000. However, this growth rate does not seem sustainable and investors will have to be satisfied with an

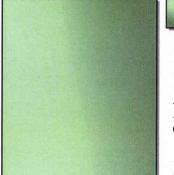
expected negative growth rate for 2001. Nevertheless, the magnitude of EPS and DPS should compensate for this growth outlook. At an expected 44.2p for 2002, Community Hospitals will be able to offer a 60 per cent higher EPS and a 160 per cent higher DPS than the Healthcare sectors flagship, Nycomed Amersham.

The relatively high and increasing dividend yield classifies CHG as a value company, which, at a dividend cover of more than two, should be able to meet liabilities towards its shareholders comfortably.

4.10 Conclusive Remark

The results demonstrate that CHG have a strong future as an independent group making a sale a strategic option rather than a strategic imperative. The health of the hospital sector has improved sharply since the BUPA bid of 650p per share in April 2000. Since then, more investors have re-discovered the steady-growth health sector and found this an ideal place to recover from the shock of the burst internet-bubble.

The future is looking bright for CHG, with more patient activity coming from the NHS. In fact, there is no apparent need to sell the group and even if it is sold, a substantial premium can be demanded. However, the government ordered the sale of BUPA's 26.7% stake in the company. Since the group has not got the resources to buy this stake back themselves, bidding for CHG is likely to continue with short-term price fluctuations to be expected.



NESTOR HEALTHCARE GROUP

(Bloomberg: NSR LN; Datastream: NSR)

BUY

UK Equity Analysis
Healthcare Sector

Current Price: 565p

52 week high:

636p

52 week low:

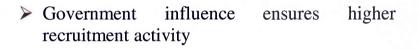
379p

Market Capitalisation:

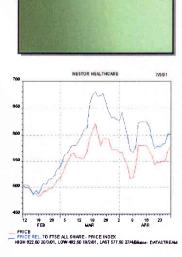
£426m

Index

FTSE SmallCap



- ➤ Strong underlying business performance, with EPS growth expected to be 20% in 2001
- ➤ Continuous search for niches in a growing market. This allows to operate in environment with low competitive pressure
- ➤ Increasing importance of Healthcare Service Division, which picks up on demographic changes
- > Technical Analysis reveals long term upward trend



Key Data	1999	2000	2001(E)
Norm Pretax (m)	13.0	18.5	22.1
Norm EPS (p)	11.0	16.4	19.8
DPS (p)	5.58	6.61	7.80
DY (%)	1.03	1.22	1.44
Norm PER (x)	49.4	33.1	27.5
Next AR year end		31/12/0	

Chapter 5

Investment Analysis of Nestor Healthcare Group Plc



Nestor Healthcare Group plc

5.1 General

Nestor Healthcare Group Plc is a UK holding company for a group of companies in the healthcare and specialist personnel sectors. The group's services include the provision of nurses, therapists, medical technicians and doctors. They also supply services to prisons and secure units, in addition to offering Forensic care services. Nestor plc is organised into two divisions: Healthcare Personnel and Healthcare Services.

With a turnover of £245m, the Healthcare Personnel Division contributes nearly five times more than the Healthcare Services Division towards total Group turnover. The rationale behind this strong contribution is due to a number of factors. First, there is a shortage of nurses and paramedics due to bad working conditions and inappropriate pay in the UK health sector, particularly in the NHS. BNA, the group's core nursing agency, is the largest provider of flexible staffing to Trust hospitals and to the private healthcare sector. The channelling of staff to vacancies will remain a lucrative business until the NHS has fully recovered and confidence in it is restored.

Secondly, the nursing population in the UK is ageing. This indicates, that insufficient junior staff is recruited or retained in the health sector, narrowing down the pool of nurses to select from. As a result, companies operating in this sector may have to settle for second-best staff given their current availability. However, as gross expenditure in the 2001 budget considers the NHS substantially, industry-wide wage will be revised upward. This monetary incentive scheme will ensure that sufficient employees are attracted to this industry. More nurses, paramedics and support staff attracted to the sector directly translates into quantitatively more staff on Nestor's Database, increasing the chances of matching labour supply and demand.

5.2 Recent Events

In 1999, Nestor sold its stake in their US healthcare associate marking the launch of the re-positioning programme. Since then, it has solely been concentrating on the UK health market and is currently taking advantage of any occurring profit opportunity.

In the following year, the group made a total of three acquisitions costing some £11m. LPNS, Bankvalve, and Hertford Medical International are a nursing agency, a homecare unit and a cardiac monitoring specialist, respectively. These supplementary businesses are expected to generate operating profits of £1.5m in 2001.

In July 2000, the government took major steps to strengthen the position of the NHS. Its budget is set to rise by 7% (to about £70m) by 2004 in order to reduce waiting time and improve levels of treatment. As these targets will require the recruitment of desperately needed quality staff, Nestor will be able to take substantial advantage in the next few years.

In 2000, the group has made substantial management changes in both personnel and reporting lines, reflecting the need to re-organise their operational structure as the newly acquired businesses have to be incorporated and integrated. These changes also reflect the need for separate strategic focus on Nestor's two operating divisions.

5.3 Cyclicality

Nestor Group Plc's main turnover pillar is the Healthcare Personnel Division, with the British Nursing Association and Grosevenor Group accounting for around 70% of total group turnover. Owing to the ailing situation of the main client, the NHS, Nestor find themselves in a position of 'cyclical immunity'. Over the next three to four years, the government will be investing money to an extent where it does not matter to the group's turnover whether the economy on the whole is in an up- or downturn.

Similarly, the Concordat between government and private health sector ensures momentum in Nestor's Healthcare Services Division. The group has positioned itself to take full advantage of the collaboration with the NHS and is expected to benefit enormously, despite the general economic slowdown in the UK.

5.4 Competitors

Although a member of the UK Health sector, Nestor resembles more a recruitment company rather than a genuine healthcare company. Due to high specialisation in the provision of flexible staff to the NHS, the company has virtually no competitors. The only competitive pressure stems from other, more generally oriented recruitment companies, such as EMDS or Michael Page.

The groups direct engagement in the provision of genuine Health-service is also meeting an environment characterised by low competition. The reason for this is the sheer size and value of the Heathcare market rather than the lack of competitors. At an estimated growth rate of 21% *per annum*, the transaction volume of this market will reach GBP87bn over the next three years. Positioning in niches (particularly niches which seem unattractive to other market players) ensures the capture of many small scale chunks of this total volume.

5.5 Strategy

After the sale of their American Personnel arm, Nestor started to re-focussed on strategic objectives in the UK. Its basic principle is to take advantage of niches wherever they occur and where there is little competition. A classic example is Nestor Prison Healthcare, where the level of need is high and competition is practically non-existent.

Nestor's vision is to be the number one private sector provider of health and social care personnel in UK, which is achieved on three levels; organic growth, growth through acquisitions and the continuous development of new businesses. The management's focus on operating profit and working capital has already had positive effects on operating margin, profit and cashflow in the Personnel Division. However, even with the concordat between the private and public health sector, the total growth rate of this division was slowing to single digits. Diversification in the lucrative Healthcare Division ensures that the group growth rate continues its impressive four year history.

5.6 Turnover and Profit Analysis

in £m	1996	1997	1998	1999	2000
Turnover	130.0	144.3	221.4	273.4	292.8
Change	n/a	11.0%	53.4%	23.5%	7.1%
PBIT	-1.5	9.9	13.4	7.8	16.4
Change	n/a	1050%	35.4%	-41.8%	110%

After turnover increases of 53.4% and 23.5% in 1998 and 1999 respectively, the 7.1% improvement in 2000 appears disappointing. However, the year 2000 was the first full

Source: Datastream

Rates of Change 1997-2000

150
100
50
1997
1998
1999
2000

Turnover change% — PBIT change %

year of the UK operation focus and Healthcare provider. Note that the 1997 rate of change in PBIT is excluded in order to provide a sensible representation of the group's performance.

Whilst BNA's turnover development was flat in 2000, its underlying turnover growth excluding the effect of low-margin contracts was in double digits. These contracts terminated last year, putting BNA back in the position of the most important turnover growth contributor for 2001. The 2000 growth rate was heavily influenced by performance of the Grosevenor Group, with turnover growth of 10.2%. With the assistance of three newly opened branches, the current share of 17% of the total Personnel Division turnover is expected to be increased in 2001.

Turnover in Healthcare Service Division increased by 1%, a development which was mainly driven by the acquisition of FMS. Allowing some time for the full effects of this and other acquisitions in the Healthcare Service Division to develop, this arm of Nestor is becoming increasingly important as a turnover driver and as risk diversification.

Although turnover growth and growth prospects appear impressive, the group does not seem able to translate turnover into profit. In other words, the management have only been able to extract *Profit after Tax* of only GBP11.4. This is due to strategic repositioning and associated acquisitions, which are now fully operational and should contribute towards continuing the 2000 *PBIT* growth trend.

5.7 Divisional Analysis

Nestor Healthcare Group plc is divided into Healthcare Personnel and Healthcare Services. *Healthcare Personnel* comprises the following:



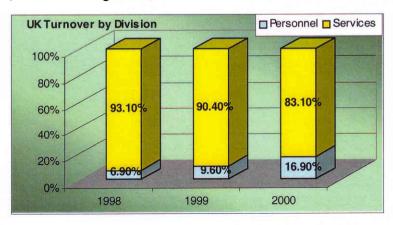
BNA: The provider of temporary nurses and care assistants continues to be the organisational core-pillar with an annual turnover of £190.7m in 2000 (190.8m in 1999). BNA continues to be largest provider of flexible staff to NHS with an underlying double digit growth rate, excluding the effect of low margin contracts.



Grosvenor Group: The three subdivisions of the Grosvenor Group are Grosvenor, Medico and LPNS and specialise in the provision of specialist nurses, temporary nurses and care assistants, respectively. This sub-groups turnover contribution was up 68% in 2000, amounting to £42.7m.

Other Personnel Businesses: This least important branch of Nestor in terms of both past growth performance and future prospects comprises Medic International, Carewatch and Country Cousins.

The *Healthcare Services* Division is made up of NMDS (provision of Doctors' deputising services), NDA (responsible for Servicing the Benefits Agency contract), FMS (provision of healthcare and related services in a secure environment), Primecare (Disease Management), and the new Healthwatch business (Remote Health monitoring).



The turnover from the UK Healthcare Services was up 1% in 2000, with magnificent individual growth performance of 233% (Forensic Medical Services) and 175% (Primecare). This proves

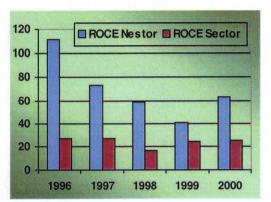
that Nestor are taking advantage of the growing opportunities in the primary care sector.

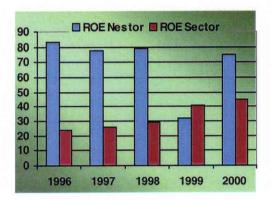
5.8 Ratio Analysis Performance Ratios

PROFITABILITY		1996	1997	1998	1999	2000	Mean
ROCE (%)	Nestor	110.57	73.18	59.32	40.38	63.42	69.37
	Sector	26.66	26.40	15.95	23.86	24.99	23.57
Margin (%)	Nestor	5.43	4.61	4.08	3.70	5.85	4.73
	Sector	10.48	9.64	8.95	7.30	7.26	8.73
Tax Ratio (%)	Nestor	-102.37	26.5	28.56	58.94	30.85	8.50
	Sector	32.53	34.83	52.33	40.57	38.74	39.80
ROE (%)	Nestor	83.03	77.96	78.75	32.05	74.98	80.38
	Sector	24.04	25.84	28.91	40.68	45.03	32.90

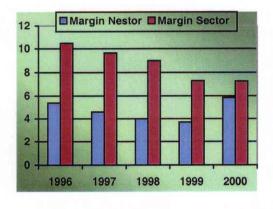
Source: Datastream

The ROCE is strong compared to that of the sector and to the 1999 figure. With rising





net assets, this improvement is due to a proportionally stronger increase in *Profit before Interest and Tax*. Responsible for this drastic improvement compared to the previous year's ROCE of 40.38 are the effects of organic growth and acquisitions, which contributed an additional £5.3m in 2000.



Nestor's strategy of concentrating on operating margin improvements seems to work. In 2000, the margin pressure experienced in the previous three years was released with Nestors operating margin approaching the industry average. In fact, the 1999 margin figure does not provide a conclusive view on the operating performance

as the acquisition of BNA distorts the picture. The driver of the 2000 improvement was the performance of the UK Healthcare Personnel where *like-for-like* cost of sales were cut drastically.

The five-year tax ratio average is adversely influenced by the one-off 1996 ratio. Nestor now pay taxes close to the higher band of UK corporation tax, some 20% less than other sector members.

Return on Equity has generally been strong over the last five years, except for 1999, where exceptional items of £5.2m (cost of disposal of US Cross Country Staffing) were incurred. A further contribution to a stronger ROE in 2000 came from a 40% increase in intangibles to £31m. Since Datastream calculates ROE by deducting *Intangibles* from *Equity capital and reserves* in the denominator, this ratio becomes higher. Nevertheless, the strongest fundamentally positive influence on this ratio came from the increase in *Profit after Tax* of nearly 400%.

ACTIVITY		1996	1997	1998	1999	2000	Mean
Activity (%)	Nestor	17.77	10.63	10.06	8.55	10.41	11.48
	Sector	2.45	2.51	1.60	2.99	3.18	2.55
Stock Days	Nestor	0	0	0	0	0	0
	Sector	47.97	47.14	81.16	44.8	39.89	52.19
Debtor Days	Nestor	41.05	57.87	59.37	53.89	51.02	52.64
	Sector	72.23	71.18	124.26	71.01	68.94	81.53
Creditor Days	Nestor	22.14	26.42	31.11	32.47	35.84	29.60
	Sector	68.37	69.87	133.67	73.38	66.53	82.36

Source: Datastream

Nestor's positive ROCE development was driven by both, operating margin improvements as well as an increase oft Activity to 10.41%. This implies a more effective use of fixed assets and working capital, which translates into higher turnover. The reason for the Activity ratio to be at a substantial premium to that of the sector is the nature of Nestor's business. The company is practically a recruitment company. Once buildings, offices and IT are set up, there is little need for further investments in the basic organisational structure until the full capacity of these investments are reached. This fact is underlined by the development of *Tangible fixed assets*, which were almost unchanged in 1999 and 2000.

The company does not seem to have a problem collecting its debt. In fact, substantial amounts were invested in implementing a billing system, which reduces the collection time. The positive influence of this system shows in the steady reduction of debtor days over the last two years. At the same time, creditor days are rising slightly.

Corporate Finance Ratios

SOLVENCY		1996	1997	1998	1999	2000	Mean
Interest Cover	Nestor	-9.7	174.41	29.07	12.29	58.81	52.98
	Sector	13.5	12.65	5.27	6.03	5.82	8.65
Borrowing Ratio	Nestor	0.04	0.47	0.95	0.19	0.28	1.93
	Sector	0.43	0.5	1.52	1.87	1.95	1.25

Nestor's Balance Sheet reveals that there are no long-term creditors as stakeholders in the company. Its liabilities are short-term, allowing *profit before interest and tax* to cover outstanding interest payments comfortably. The company is also predominantly equity financed as represented by the borrowing ratio, giving a second explanation for the relative strength of the Interest Cover.

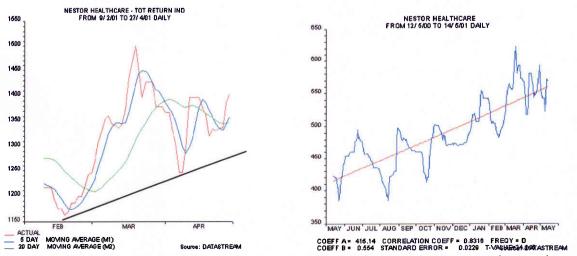
LIQUIDITY		1996	1997	1998	1999	2000	Mean
Working Capital	Nestor	1.39	1.37	1.10	1.58	1.41	1.37
	Sector	1.36	1.39	1.32	1.34	1.37	1.40
Quick Ratio	Nestor	1.39	1.37	1.10	1.58	1.41	1.37
	Sector	0.9	0.95	0.88	0.90	0.94	1.1

Source: Datastream

In terms of liquidity, the group appears sound as well. Here, the Working Capital ratio coincides with Quick Ratio as Nestor is a pure service provider where no stock is accumulated. However, active management of stock, debtor and creditor days may provide scope for liquidity improvements.

5.9 Technical Analysis

This total return graph reveals a relatively weak cross-over of five day and twenty day moving averages. A resistance line can be drawn from the lowest February point to the



latest steep fall in April, allowing downward fluctuations in the current share price of about ten per cent.

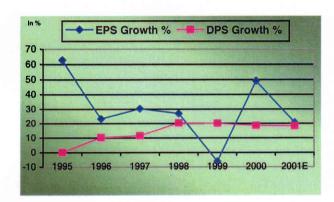
Taking into consideration the share price movement over one year, a clear upward trend is observable.

5.10 Investors Ratios and Financial Forecast

Year to end Dec	norm Pre-tax Profit (m)	EPS (p)	CFPS (p)	DPS (p)	DIV. COVER (x)	DIV. Yield (%)
1998	12.7	11.97	3.94	4.65	2.52	n/a
1999	13.0	11.21	6.96	5.58	1.97	1.03
2000	18.5	17.10	8.01	6.69	2.48	1.22
2001E	22.1	19.80	n/a	7.80	2.53	1.44

Source: REFS guide, Feb 2001

Due to the government's agenda to increase NHS staff, turnover has seen an increase of



forty per cent in 2000 and is expected to grow by twenty per cent in 2001. Hence, EPS are experiencing a similar development with a cumulative increase of an impressive 76 per cent in 2000 and 2001. DPS have been growing fairly consistently at around 20 per cent over the past three years.

The dividend yield is the ratio of the previous year's dividends to the market price. It is thought to have increased by about 40 per cent from 1999 until 2001, bringing Nestor on the path of becoming a value company. The dividend cover is at around 2.5 more than sufficient to meet dividend payments in 2001.

5.11 Conclusive Remark

Nestor's external environment is extremely favourable to the company. On the personnel side, government involvement almost guarantees profitable trade for years to come. On the healthcare side, Nestor has been able to secure niche chunks out of a vast nominal market size. Due to remarkable management, new business activities, such as Prison Healthcare, typically become rapidly profitable. In addition, Nestor look strong fundamentally. Improving performance ratios complements sound liquidity and solvency and continuous efforts to reduce margin pressure are already fruiting. However, there is still scope for improvements, especially on an efficiency level within the organisation. The optimal outcome for the company would be to engage in strategic alliances or acquisitions in order to take advantage of scale economies and synergy effects.



(Bloomberg: NAM LN; Datastream: NAM)

BUY

UK Equity Analysis
Healthcare Sector

Current Price: 544p

52 week high:

710.5p

52 week low:

413p

Market Capitalisation:

£3,689m

Index :

FTSE 100

- ➤ World market leadership in lucrative Imaging business and good positioning of APBiotech to occupy leading role in Biotechnology market
- ➤ Profit forecast to lift off in future years as management able to maintain profit margins at 16%.
- > Solid profitability and corporate finance fundamentals
- > Technical Analysis in Support of buying decision
- ➤ Just gone Ex-Dividend, hence relatively cheap

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FEB PRICE	MAR.	APK

Key Data	1999	2000	2001E	2002E	
Norm Pretax (m)	234	231	273	309	
Norm EPS (p)	21.1	22.5	24.8	27.8	
DPS (p)	5.90	6.20	6.70	7.50	
DY (%)	1.01	1.10	1.22	1.31	
Norm PER (x)	22.6	22.0	20.2	18.0	
Next AR year end		31/12/0	1		

Chapter 6

Investment Analysis of Nycomed Amersham Plc



6.1 General

Nycomed Amersham Plc constitutes an international group engaged in the research and development, production, sale, distribution and licensing of medical products. The Group breaks down into two divisions: NA Imaging concentrates on products for the diagnosis of diseases and includes contrast imaging products, such as magnetic resonance, X-ray and Ultrasound imaging. Amersham Pharmacia Biotech is a leading provider of biotechnology systems and solutions for research into genes and proteins, the discovery and development of drugs, and the manufacture of biopharmaceuticals.

Nycomed Amersham Imaging



The Imaging business is the world's leading provider of a variety of valuable innovative products used in the diagnosis and treatment of disease. 580m medical imaging procedures were performed last year, of which one in six requires an imaging agent. The importance of the provision of imaging agents is

reflected in the worldwide demand, which was an estimated £2bn in 2000.

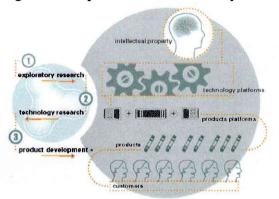
Nycomed Amersham Imaging is involved in the manufacture and provision four main medical imaging modalities, X-ray (including computer tomography- CT), magnetic resonance imaging (MRI), radiopharmaceutical imaging (RPI) and ultrasound. While RPI always requires the support of an imaging agent, it is optional for the other three types of screening.

Imaging will continue to grow in importance due to the influence of two factors. On one hand, imaging is imperative when diagnosing age-related diseases such as cardiovascular disease, cancer and neurological disease, such as Altzheimer's disease and depression. As the population undergoes demographic changes, this market has

excellent growth prospects. On the other hand, advances in technology are already providing opportunities for imaging products beyond mere diagnosis.

Amersham Pharmacia Biotech

APB is a leading provider of biotechnology systems and solutions for research into genes and proteins, the discovery and development of drugs, and the manufacture of



biopharmaceuticlas. The worldwide demand for lifescience products is estimated to be six times that of Imaging products. However, as the lifescience market is very fragmented, individual firms are only able to capture a small market share of the £12.5bn annual total. Within this total, there are many distinct

market segments, each with differing growth drivers and dynamics.

Following the re-structuring of the business after the merger of Amersham Intl Plc and Nycomed AS in 1997, the life science business was separated into three categories-drug discovery, research products, and industrial separation. This break up ensures that customers in the individual segments are targeted more effectively and divisions are managed more efficiently.

6.2 Recently...

As the US are entering recession, first quarter results for 2001 reveal a general slowdown in R&D expenditure on behalf of biotechnology companies. For a company like Nycomed, this development could be disastrous if all business arms were affected equally. While the Imaging business is left untouched by this trend, the Lifescience side is hit harder. However, product diversification ensures that such market movements will only affect a minimal amount of business. Sales of AP Biotech even grew by 21% to £154m. Although this trend is unlikely to be sustainable due to fiercer competition, AP Biotech is generally well positioned against a drastic fall in R&D expenditure. First quarter Imaging sales were ahead of expectations, growing 13% to £221m.

On 11th April 2001, the management announced the launch of NeoSpect, an innovative molecular diagnostic product used to identify lung cancer. Since lung cancer patients live on average another nine months after diagnosis, this product promises tremendous

success in fighting the most common cause of cancer death. Not only does it enable sooner diagnosis but it is also considerably cheaper for the healthcare sector. Also, unlike traditional methods, the NeoSpect is not followed by an invasive procedure, thereby providing more comfort for the patient.

Recent market conditions delayed plans to float 10% of AP Biotech on NASDAQ. As the downfall of the NASDAQ seemed to have come to a halt, floating could be imminent and would bring up the value of Nycomed Amersham to \$4bn.

6.3 Competitors

Total Imaging Market Share 2000	Total Imaging Market Share 2000						
Nycomed Amersham	36%						
<u>Bracco</u>	20%						
Schering	13%						
DuPont	8%						

Nycomed Amersham are the world market leader in the Imaging Market, with competition mainly coming from the US and Germany. However, the comfortable lead of 36% of total market share is almost the share of the three runners-up taken together. As Nycomed Amersham continue the provision of innovative screening products (e.g. lung cancer screener), they should be able to sustain and expand their position in the market.

Radiopharmaceutical Imaging N	Market Share	X-ray Imaging Market Share		
Nycomed Amersham	40%	Nycomed Amersham	36%	
Du Pont	24%	Bracco	33%	
Mallinckrodt	7%	Mallinckrodt	15%	
Others	29%	Schering	12%	

Particularly impressive is the market share in the strategically most important segment of Imaging. Nycomed Amersham were able capture 40% of the Radiopharmaceutical Imaging market, with the nearest competitor far off Nycomed's superior position.

With respect to X-ray Imaging, the group is faced with slightly higher competition, although the market leader position was at 36% market capture also maintained.

Amersham Pharmacia Biotech's environment is characterised by the presence of thousands of niche suppliers. Competition in this heavily fragmented life science market is tight, making it virtually impossible to identify other firms competing for a share of the total world market value of £12.5bn.

6.4 Strategy

Over the last decade, Nycomed's strategy was driven towards playing an influential role in the new medical revolution, where diseases are understood better, diagnosed earlier and treated more effectively. Following the disclosure of the genetic code in humans, medicine will be applied more specifically to the individual genetic properties of each patient. Nycomed part-takes in this fundamental re-organisation of the sector through providing methods and solutions enabling the rapid acceleration in genetic understanding.

The second strategic focus is on the expansion of the diagnostic equipment market share, thereby exploiting demographic trends. As the population becomes older, chronic diseases are affecting a wider patient base. Nycomed's Imaging products help identify these diseases quicker and allow more effective treatment.

Continuous disposal of non- core value adding activities, acquisitions, active 'product life-cycle management' and strategic supply-alliances supplement organic growth in both divisions.

6.5 Cyclicality

The Imaging side of Nycomed's business can be regarded non-cyclical, as the demand for diagnostic material is fairly immune to an economic slowdown. Also, the group's customer base is scattered around the world, making it even less likely that Nycomed Imaging will be hit hard by the slowdown in one particular region.

The position of the Lifescience division in an economic downturn is slightly more problematic. The sudden economic slowdown in the US meant that biotechnology companies are reducing their R&D expenditure drastically. However, only five per cent of total sales are exposed to Biotechs. The remaining 95% stem from financially stable sources such as big pharmaceuticals and academic institutions.

6.6 Turnover and Profit Analysis

in £m	Mar-97	Dec-97	1998	1999	2000
Group Turnover	426.4	593.1	1,392.1	1,375.2	1,377.3
Change	n/a	39.1%	134.7%	-1.21%	0.15%
Group PBIT ¹	67.1	81.9	262.5	260.9	240.9
Change	n/a	22.1%	220.5%	-0.61%	-7.67%

Source: Datastream

The merger, which resulted in the creation of Nycomed Amersham in 1997, had its main impact on turnover in 1998 with a growth rate of 135%. Although total turnover growth has remained static in the two subsequent years due to the continuing disposal of non-core assets, turnover from continuing operations was up 13.9% to £1,271.6m in 1999 and 8.3% to £1,377.3m in 2000.

The group's PBIT, as given in the five-year history, improved dramatically as a result of the merger, but seemed to have lost momentum in 1999 and 2000. The fall of nearly 8% in 2000 is attributable to a 17% increase in R&D expenditure to £23m and adverse currency movements, which dented profits by roughly £6m.

6.7 Divisional Analysis

	200	00		1999			
Turnover	%	Op. Profit	%	Turnover	%	Op. Profit	%
773.9	56.2	194.6	80.8	728.8	57.3	178.1	71.1
603.4	43.8	63.0	26.2	542.7	42.7	82.2	32.8
-	0	-16.7	-7.0	0.1	0.0	-9.7	-3.9
	773.9 603.4	Turnover % 773.9 56.2 603.4 43.8	Turnover % Profit 773.9 56.2 194.6 603.4 43.8 63.0	Turnover % Op. Profit % 773.9 56.2 194.6 80.8 603.4 43.8 63.0 26.2	Turnover % Profit % Turnover 773.9 56.2 194.6 80.8 728.8 603.4 43.8 63.0 26.2 542.7	Turnover % Op. Profit % Turnover % 773.9 56.2 194.6 80.8 728.8 57.3 603.4 43.8 63.0 26.2 542.7 42.7	Turnover % Profit % Turnover % Profit 773.9 56.2 194.6 80.8 728.8 57.3 178.1 603.4 43.8 63.0 26.2 542.7 42.7 82.2

Although Nycomed Amersham's main turnover and profit contributor is NA Imaging, R&D expenditure in APB has risen significantly, reflecting the strategic importance of capturing a high as possible market share in this lucrative life science market. Here, R&D expenditure increased £20m, or 35%.

6.8 Geographical Analysis

In £m	0.5	200	10	1999				
	Turnover	%	Op. Profit	%	Turnover	%	Op. Profit	%
Europe	766.3	43.0	146.9	57.0	725.9	44.6	134.9	52.8
North America	743.3	41.7	74.2	28.8	673.8	41.4	96.9	36.8
Japan	206.8	11.6	34.6	13.4	176.6	10.9	27.7	11.1
Asia Pacific	58.2	3.3	1.8	0.7	46.7	2.9	1.1	0.4
Rest of the World	6.9	0.4	0.1	0.04	4.6	0.3	-0.3	-0.1

42

¹ Before exceptional items

Imaging: The Imaging division showed strong growth in the US for all medical diagnostic products, with turnover up 15% to £355m. This trend was mainly driven by volume growth in X-ray diagnostic products, which was up 11% to £167m on one hand and through the performance of Myoview on the other hand. Myoview achieved growth of 37% to £67m, heavily influenced by the Novation alliance.

In Europe, Imaging sales decreased to £162, a minus of 4% compared to last year. This is attributable to market changes ahead of German health reform and a reduction in bulk sales. In Japan, sales grew by 18% to £168m.

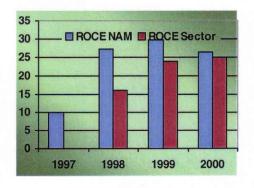
Lifescience: The Life science division managed to deliver particularly large orders in the bioprocess area to customers in Europe and the US and should benefit from new product launches in drug discovery.

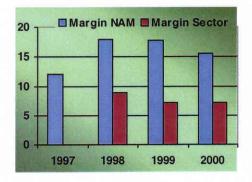
6.9 Ratio Analysis Performance Ratios

The 1997 merger changed the nature, size and performance of Nycomed Amersham enormously. Ratios calculated on the basis of pre- 1997 figures may be misleading in finding a conclusive historical trend. Hence, the mean is based on the previous three years, where the full effect of the merger is reflected in performance, corporate finance and investor's ratios.

PROFITABILITY		Mar-97	Dec-97	Dec-98	Dec-99	Dec-00	Mean
ROCE (%)	NAM	29.93	10.11	27.13	29.73	26.42	27.76
	Sector	n/a	N/a	15.95	23.86	24.99	23.57
Margin (%)	NAM	13.96	12.12	17.93	17.69	15.60	17.07
	Sector	n/a	N/a	8.95	7.30	7.26	8.73
Tax Ratio (%)	NAM	40.58	-2.75	36.49	39.78	39.34	38.54
	Sector	n/a	n/a	52.33	40.57	38.74	39.80
ROE (%)	NAM	33.65	100.38	323.21	60.25	47.16	143.54
	Sector	n/a	n/a	28.91	40.68	45.03	32.90
						Source: Dat	astream

Although ROCE and ROE have been above the sector's over the past three years, Nycomed Amersham's main indicators of profitability are declining and approaching





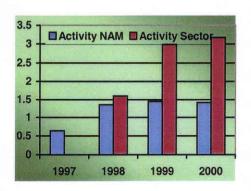
the sector average. With the Activity ratio almost unchanged, downward pressure on ROCE was caused by a twelve percent margin decline in 2000. This is due to the decline in operating profit after an increase in R&D expenditure, particularly in Amersham Pharmacia Biotech, as well as missing turnover contributions from discontinued operations. The decline would have been stronger if it was not for the decrease in intangibles. As Datastream deducts intangibles from total capital employed in ROCE's denominator, the company appears stronger with respect to Profitability. *Profit after tax* was £144.9m in 1998, £143.0 in 1999 and £141.8 in 2000. With fairly stable PAT figures, the sharp deterioration in ROE must be attributable to an increase in *Shareholder's funds*. Indeed, the dramatic development of the company's Profit and Loss Account, showed that contributions to Equity Shareholder's funds were up from £44.9m in 1998 to £246.3 in 2000.

These ratios may remain somewhat volatile, especially if R&D expenditure has to be increased in order to shake off competition. Otherwise, they may settle around the industry average as Nycomed Amersham has completed the merger with no abnormal influences from discontinuing operations.

ACTIVITY		Mar-97	Dec-97	Dec-98	Dec-99	Dec-00	Mean
Activity (%)	NAM	1.6	0.64	1.36	1.45	1.42	1.41
	Sector	n/a	n/a	1.60	2.99	3.18	2.55
Stock Days	NAM	40.32	134.85	59.25	41.52	48.70	49.82
	Sector	n/a	n/a	81.16	44.8	39.89	52.19
Debtor Days	NAM	95.76	215.91	109.08	109.71	106.38	108.39
	Sector	n/a	n/a	124.26	71.01	68.94	81.53
Creditor Days	NAM	77.87	248.49	113.12	94.29	91.42	99.61
	Sector	n/a	n/a	133.67	73.38	66.53	82.36

Source: Datastream

With high nominal turnover, the relatively weak Activity ratio is attributable to a strong capital employed position. With capital employed figures of £1155m in 1998, £1043m



in 1999 and £1047m in 2000, Nycomed Amersham's business environment requires the company to employ comparatively more fixed and current assets than the other three companies in analysis. In other words, high capital employed figures are typical for a company heavily involved in biotechnology and the production of medical

equipment. This notorious capital intensity combined with the loss of revenue from discontinued operations left the Activity ratio stable, but at a considerably lower level

than the sector average. Though sales growth of continuing activities remains strong, the Activity ratio is unlikely to approach the sector average in the coming years as it is imperative to keep propping up assets and investments in order to secure the highest possible market share.

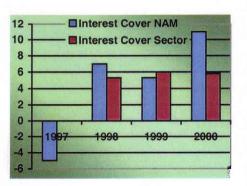
The fundamental mismatch between creditor and debtor days would raise concerns only if liquidity was endangered. With a stronger than industry average working capital and quick asset ratio, this should not be of concern, though.

The time a finished product reaches the customer is expressed by stock days, which increased by seven days in 2000. Given the drastic development of the nominal amount held in stock over the last two years (£147m in 1999 and £171m in 2000) efforts should be made to converge towards the industry average.

Corporate Finance Ratios

SOLVENCY		Mar-97	Dec-97	Dec-98	Dec-99	Dec-00	Mean
Interest Cover	NAM	16.67	-4.95	6.97	5.33	11.06	7.79
	Sector	n/a	n/a	5.27	6.03	5.82	8.65
Borrowing Ratio	NAM	0.85	6.86	14.72	2.13	1.44	6.10
	Sector	n/a	n/a	1.52	1.87	1.95	1.25
THE RESERVE OF THE PARTY OF THE						Source: Data	stream

Traditionally, Biotechnology companies are debt-financed. This is also true for



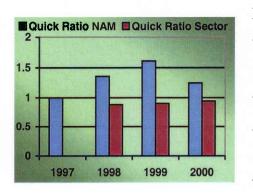
Nycomed, where loans and other creditors outweigh equity capital. As the 2000 interest cover is at 11 times almost twice that of the sector, Nycomed can be regarded as a safe investment regarding default risk. In fact, they are more able to service their debt than a company with figures identical to the health sector average. Such credit

rating ensures flexibility as it allows reverting to loan finance when the environment demands rapid reaction to new trends.

LIQUIDITY		Mar-97	Dec-97	Dec-98	Dec-99	Dec-00	Mean
Working Capital	NAM	1.60	1.48	1.92	2.04	1.69	1.88
	Sector	n/a	n/a	1.32	1.34	1.37	1.40
Quick Ratio	NAM	1.20	1.01	1.36	1.61	1.25	1.40
	Sector	n/a	n/a	0.88	0.90	0.94	1.1

Source: Datastream

Although these liquidity measures signal a stronger than sector average position,



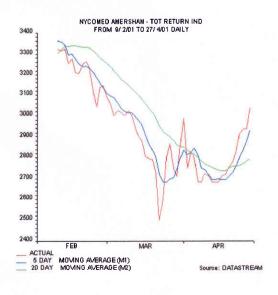
Nycomed's management should carefully monitor the downward trend in Working capital set by the 17% fall in 2000. The main contributors to this trend are the increase in *stocks* by 16% to £171.1m and the increase in *creditors due within one year* by 12% to £381.1. If these two positions continue their trend over a period of five to six years, then

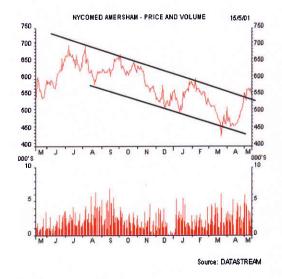
liquidity problems may be faced.

The quick ratio's decline in 2000 was caused by a fall of the most liquid current assets. A reduction in *short term deposits and investments* by about £58m and in *Debtors due within one year* by roughly £20m resulted in the decrease of the numerator by £78m to £480m. At the same time the denominator increased, as shown in the Working Capital analysis.

6.10 Technical Analysis

With confidence in growth stocks returning, Nycomed's share price is recovering as well. In April, the upward sloping very short term moving average crossed the also upward sloping twenty-day average. That this was a clear sign to buy is proven by the subsequent eight per cent rise in share price.



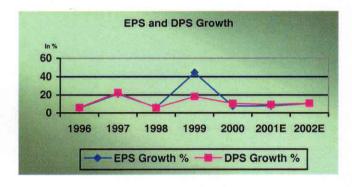


Ignoring the exceptional outbreak of the share price in March 2001, a long-term support line can be drawn. This is positioned around the 450p mark and allows for a price correction of roughly 100p. A resistance line was broken at 510p. This is a clear purchasing sign. In terms of liquidity, Nycomed look expectedly strong, bearing in mind the membership in the FTSE 100.

6.11 Investors Ratios and Financial Forecast

Year to end Dec	Pre-tax profit (m)	EPS (p)	CFPS (p)	DPS (p)	P/E (x)	P/CF (x)	Gross yield (%)	EV/ EBITDA (x)
1999	234	21.1	-2.9	5.9	22.6	-170.3	1.2	10.6
2000	231	22.5	10.7	6.2	22.0	46.7	1.2	10.7
2001E	273	24.8	16.4	6.7	20.2	30.5	1.3	9.5
2002E	309	27.8	19	7.5	18.0	26.3	1.5	8.5

Source: Datastream



The EPS and DPS position of Nycomed Amersham appear to be solid, yet relatively low in comparison to the other three companies in analysis. However, this comes as no surprise as biotechnology companies are still

very much in their growth stage. Since 45% of Nycomed Amersham's business activity is directly related to the Biotechnology sector, relatively low dividends and gross yields are to be expected. Similarly, EPS (p) and EPS growth are heavily influenced by investments in new businesses and expansions into innovative product areas, restricting earnings to grow at a consistently high rate. Nevertheless, PER and EV/EBITDA signal that the share price will converge towards earnings, leaving these ratios at a lower level. Combined with a slightly rising dividend yield, this indicates a move towards becoming a value company until 2002.

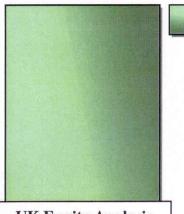
The most interesting issue about Nycomed is its mixture between value and growth and how investors perceive the stock to be. In an economic downturn, investors seem to associate Nycomed with a value company, which follows the trend of the overall market. In contrast, when confidence in the technology and biotechnology stocks rises, Nycomed is seen as a company with immense growth potential. During the new economy hype in March 2000, Nycomed's share price shot up from 300p to 730p. Where similar companies experienced a subsequent sharp fall from which many of them

have not recovered yet, Nycomed managed to re-reach this high level in August 2000, after the price had corrected to 500p. At a range of ten and fifty per cent it has been consistently higher than the FTSE All Share ever since. With the rediscovery of Technology stocks on stock markets world-wide, investors in Nycomed may hence be able to benefit from capital gains substantially.

6.12 Conclusive Remark

The mix between value and growth company makes Nycomed an attractive investment opportunity in a market characterised by instability and uncertainty. Its profitability and corporate finance fundamentals appear solid, and competitive pressure seems to be fought off successfully as the very high profit margin suggests. In addition, advanced activity and country diversification make the company somewhat immune to adverse external influences (such as the industry-wide fall in R&D expenditure). The company's individual divisions continue to do well and the initial public offering of AP Biotech on NASDAQ will bring in fresh funds of \$3.3bn. Thus, Nycomed seems well positioned to take on a bigger market share in the lucrative life science market, while at the same time continuing to look strong on the Imaging side.

However, the firm has a disappointing record to live down. The year 2000 was the third year running that Nycomed declared profits below expectation. Although profits are forecast to lift off in subsequent years, confidence in this stock has to be restored on a broader level. Hence, this situation should be exploited and investments in the company should be made now.



SSL INTERNATIONAL

(Bloomberg: SSL LN; Datastream: SSL)

BUY

UK Equity Analysis
Healthcare Sector

Current Price: 536.5p

52 week high:

839.5p

52 week low:

387.5p

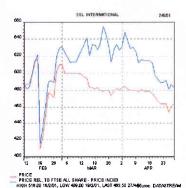
Market Capitalisation:

£899m

Index

FTSE Mid 250

- ➤ Overestimation of demand for contraceptive products created stock problems. However, this is being sorted out and production is changed towards surgical gloves for the US market.
- ➤ Very strong brand portfolio includes Durex and Scholl
- > Strong underlying business growth rate of 8%
- Appointment of new Finance Director, who will bring stability into the fast growing company and should contribute towards restoring confidence in the stock



Key Data	2000	2001E	2002E
	2000	ZUUIE	2002E
Norm Pretax (m)	120	106	118
Norm EPS (p)	49.3	43.8	48.1
DPS (p)	11.0	13.1	14.4
DY (%)	2.32	2.76	3.02
Norm PER (x)	9.65	10.9	9.90
Next AR year end		31/03/02	

Chapter 7

Investment Analysis of SSL International



7.1 General

SSL International Plc is a leading global healthcare group operating in over thirty countries. It was formed after the merger of Seton Scholl Healthcare plc with London International Group plc in June 1999, providing the new group with an expanded distribution platform for its products as well as two global brands, Durex and Scholl. As of November 2000, the group is focussing mainly on producing and marketing these brands, which ensures leadership in many of the markets SSL offers its products. Principal activities of the group include the manufacturing and supply of over-the-counter products such as health and comfort footwear, foot and legcare products, wound treatment and continence care. In addition, SSL provide a range of consumer healthcare products including surgical gloves and condoms.

The group employs over 7000 people in the UK, Continental Europe, the Far East and the US and is a member of the FTSE 250.

7.2 Cyclicality

SSL's global presence and product variety suggest that it has reduced the exposure to adverse external influences through diversification. Though the company's main profit drivers can be regarded non-cyclical (rubber gloves and condoms), other products from the cosmetics area are highly cyclical. In other words, expected growth rates of *o-t-c* footcare products may be subject to substantial downward revisions when recession is looming. Nevertheless, vital diversification efforts are taking place, with the company operating through four main divisions; the Consumer Division, the Medical Division, the Marigold Gloves Division and Other Division.

However, the company is not only reducing risk through diversification. It also relies on matching cost and revenue bases, thereby minimising the exposure to adverse currency movements. For example, moving production to Asia guarantees presence in a high turnover growth area, while at the same time costs are kept to a minimum.

7.3 Brand Portfolio

Scholl:

The Scholl brand includes footcare and footwear products and remains one of SSL's



most important turnover drivers. Promotion in existing and new markets as well as re-branding a number of existing SSL products allows the company to capitalise on the strong reputation of the Scholl brand. The brand is particularly strong in Thailand and efforts are being made to

promote Scholl footwear and -care in Eastern Europe.

Durex:

Given rising HIV infections amongst the heterosexual community in Britain Africa and



Asia, the Durex condom brand has strengthened its position as a global brand leader, whose market share is at 22 per cent almost 9 per cent higher than the nearest rival's.

In particular, expanding into the Japanese market and attempting to capture as much as possible the estimated condom retail value of GBP270m provides promising prospects. However, SSL decided to discontinue the cheaper, unbranded manufacturing of condoms. This may result in losing out on contracts with the Chinese government, which imposed birth controls in order to stop further population explosion in the Region.

Regent Biogel Surgical Gloves:



Remarkable sales growth has been achieved with powder-free gloves (Regent Biogel), with Latex surgical gloves powering growth rates. Although competition is strong in this segment, the demand for surgical gloves is so strong that many manufactures are able to coexist without

significant margin pressure. The two US firms Johnson&Johnson and Baxter are the strongest rivals in the US, Europe and Asia. In Europe, SSL is in competition with Lohmann, a German manufacturer who is flooding the European market with value-formoney surgical gloves.

7.4 Strategy

SSL's strategy is geared towards achieving a number of key financial objectives by concentrating on the two main brands, Scholl and Durex. First, like-for-like sales growth is aimed to be 6-8% and earnings per share are targeted to increase by at least 15% per annum. This is to be achieved through a combination of organic growth, strategic acquisitions and disposals. Also, the group intends to broaden their geographic presence, particularly in South East Asia and increase distribution capabilities so that goods produced in this low cost region can easily be delivered to markets where the unit price paid is high. For example, capacity has already been increased through the purchase of assets to support existing structures: Regent Biogel Surgeon's gloves are supported by assets of AMPri Rubberware Industries (Malaysia).

The medium-term target is to deliver operating profit of 25% of total sales and working capital of 15% of sales. This target is supported by a reduction in overhead costs through synergy effects. In order to meet these targets, the management should continue to focus on outsourcing non-value adding activities and on strategic acquisitions. Purchases like Silipos, the manufacturer of products incorporating tri-block polymer gels gives SSL the opportunity to use innovative technology across all core activities. In other words, these gel-based products are used in various ways to protect, cushion heal and moisturise the skin and, if applied in conjunction with existing products, will add value and desirability.

Although the stock market hype about dot.com companies seems to be over, the Internet as a channel of distribution remains a lucrative business. Especially business-to-business (b2b) transaction over the information super highway could contribute substantially to SSL's turnover growth in years to come. Their web-site is already receiving 100,000 business related hits per month. Detailed plans to capitalise on this opportunity are currently being reviewed.

7.5 Recent Problems

After the announcement that the merger of SS and London International would cost £225m rather than the originally anticipated sum of £165m and the disclosure of stocking problems, SSL's shares experienced a 40% price fall in November 2000. SSL had produced too many condoms for the European market and too few surgical- and household gloves for the important US market. As a result of this production debacle,

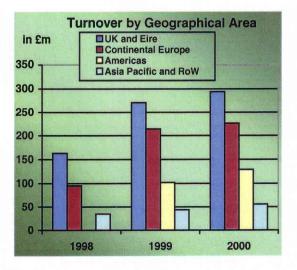
sales are anticipated to decelerate by £20m this and next year due to lower per unit prices. Nevertheless, the company insists on being able to maintain total sales growth of 6 to 8% in 2001. Production of surgical gloves will be intensified in SSL's Asian factories, where labour is cheap and production of condoms is already soundly established. The company has already announced the closure of its condom factories in Italy and Alabama in an attempt to cut cost and improve margins by moving production facilities to low cost countries.

Although many analysts believe that SSL will not need additional Asian capacity as early as they thought, it will certainly improve profitability. The effects of this homemade investor relations debacle are still looming over the company. In particular, the top-management has been criticised for its actions. They are made responsible for creating a glut of condoms and surgical gloves after deciding to cut off third party distributors around the world and deliberately overproducing ('stock-in-trade') to keep competitor's products off wholesalers' shelves. In particular, the former Chief Executive, Ian Cater, had to step down. This and yet a second profit warning led to a further 1/5th fall in SSL's share price. In February 2001, the company announced that pre- tax profits would be nearer £90m, rather than analyst's estimates of £110m.

In order to restore credibility problems and resolve serious management issues, the company appointed former Celltech Group Plc executive Garry Watts as finance director.

7.6 Geographical Analysis

The UK and Continental Europe are SSL's primary activity bases, in terms of both

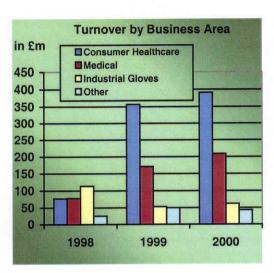


production and consumption. For the period 1998 to 2000, the average turnover growth for SSL in the UK and Europe was 37.3% and 65.7%, respectively. The newly entered US market contributed £128m turnover in 2000, representing a 25.8% increase compared with 1999. Asia Pacific and the Rest of the World (RoW) made up roughly 10% of the total group turnover in

2000. During the period, Asia's position has been strengthened. Not only is this the group's most important manufacturing location for surgical gloves and condoms, but also the termination of major distribution arrangements in the region gives SSL the freedom to sell their products in a market inhabited by over one half of the total world population.

7.7 Divisional Analysis

Consumer Healthcare falls into five sub-categorisations; Family Planning, Scholl Brand, Footwear, Footcare and Over-the-Counter Products. Family Planning includes SSL's



strongest brand, Durex, which enjoys a global share of 22%. Market share market consolidation in the US, expansion into the market and product lucrative Japanese innovation in existing markets signals promising returns for this 'cash cow'. Footcare and Footwear products are running under the Scholl brand. This brand is already one of SSL's core pillars of growth in the UK and Europe. Currently, investigations are being

carried out to extent supply into Eastern Europe. In terms of OTC- turnover, SSL are holding the runners-up position in the UK pharmacy sector.

7.8 Turnover and Profit Analysis

in £m	1996			1997					Name and Address of the Owner, where the Owner, which is the Owner, where the Owner, which is the Owner, where the Owner, which is the Owner, which i	2000
	Seton	Scholl	LIG	Seton	Scholl	LIG	SS	LIG	SSL	SSL
Turnover	84.9	207.2	309.6	102.9	211.9	339.2	223.2	345	631	705
Operating Profit	17.7	18	28.1	23.1	20.4	38.4	51.8	45.1	100.5	135.8

The turnover and Profit history of SSL is only two years old, but one is already able to see benefits from the merger of these three companies. The combined turnover of Seton, Scholl and LIG for the years 1996, 1997 and 1998 are £601.7m, £654m and £568.2, respectively. In the year 2000, the combined turnover was £705m, up 12% compared with 1999 and 24% compared with 1998. Though recent condom stocking problems will dent turnover for the year 2001, these mergers will ensure a sound turnover platform from 2002 onwards, complementing the management's emphasis on organic growth through synergy effects.

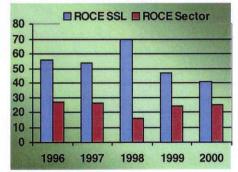
Due to concentrating on production in the low cost Far East, SSL were able to increase profits by approximately 35% in 2000. Following the closure of high cost facilities in Italy and the US as well as production relocation programmes to the less cost intensive north of the UK in 2000, profits should continue to grow at the same or even a higher rate in the foreseeable future.

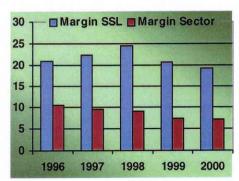
7.9 Ratio Analysis

Performance Ratios

PROFITABILITY		Feb-96	Feb-97	Feb-98	Feb-99	Mar-00	Mean
ROCE (%)	SSL	55.56	53.59	70.29	46.55	41.38	53.47
	Sector	26.66	26.40	15.95	23.86	24.99	23.57
Operating Margin (%)	SSL	20.91	22.50	24.49	20.67	19.27	21.57
	Sector	10.48	9.64	8.95	7.30	7.26	8.73
Tax Ratio (%)	SSL	30.58	29.55	26.93	51.12	-85.66	10.50
	Sector	32.53	34.83	52.33	40.57	38.74	39.80
ROE(%)	SSL	165	n/a	n/a	52.9	87.3	101.7
	Sector	24.04	25.84	28.91	40.68	45.03	32.90
						source: R	EFS Guide

The most important measure of profitability, the ROCE, ignores both tax and the company's method of financing. With an average of 53.47, SSL has been outperforming the sector by more than 100% over the last five years. This implies, the all the net assets



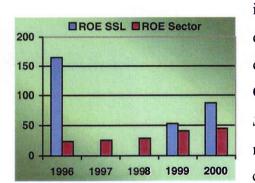


have been employed more effectively and efficiently than the sector. Furthermore it shows, that the managers' policy of outsourcing any non-shareholder value adding

activities or projects (i.e. with a persistently low ROCE) are rigorously discontinued works effectively. The steady decline of ROCE over the five-year period is due to the decrease of both the Operating Margin and the Activity Ratio. This may be of concern, especially if one takes into account that the sector's ROCE has been recovering for the last three years. This sector recovery is due to a stronger sector Activity performance of 3.18% in 2000, indicating that SSL's inferiority in utilising its net assets to generate turnover relative to the sector.

SSL have been experiencing creeping margin pressure over the last three years, with the Operating margin deteriorating by about 20%. Nevertheless, the merger between Seton, Scholl and LIG is expected to provide the group with substantial synergy effects and economies of scale. This leads analysts to believe that the margin pressure will be easing once the three firms are fully integrated.

The ROE, which takes into account not only the results of operations, but also the



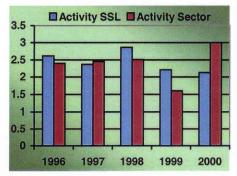
impact of financing and taxation has increased drastically over the last two years. This is mainly due to an increase in *Profit after Tax* of 37% to GBP87.8m in 2000. At the same time *Shareholders' Funds* have fallen roughly 30% as a result of a higher *Profit and Loss Account* negative contribution. It would come as no surprise if the

ROE falls in the year 2001 as losses incurred in the merger period will have been eradicated.

ACTIVITY		Feb-96	Feb-97	Feb-98	Feb-99	Mar-00	Mean
Activity (%)	SSL	2.62	2.37	2.87	2.21	2.13	2.44
	Sector	2.45	2.51	1.60	2.99	3.18	2.55
Stock Days	SSL	36.63	35.86	43.96	48.78	48.78	42.80
	Sector	47.97	47.14	81.16	44.8	39.89	52.19
Debtor Days	SSL	126.25	139.47	125.44	94.93	123.07	121.83
	Sector	72.23	71.18	124.26	71.01	68.94	81.53
Creditor Days	SSL	101.46	83.72	96.17	101.35	94.3	95.4
	Sector	68.37	69.87	133.67	73.38	66.53	82.36

source: Datastream

A falling activity ratio (Sales/ Capital employed) indicates deterioration in performance. In other words, the amount of business being done is decreasing in relation to the capital base. For the years 1999 and 2000, this fall is attributable to stocking problems, where management have artificially created a glut of condoms, neglecting increased demand



for surgical gloves. As a result turnover growth slowed and will continue to do so for another year and a half. However, these problems seem to have been sorted out as surgical glove production is increased heavily in Asian manufacturing sites.

This stocking problem is also reflected in the growing number of stock days. Although, it is industry-typical to create a flood of products in order to keep competitor's products off wholesaler's shelves, management has overestimated the demand. The cost associated with this decision is an estimated turnover loss of £20m in 2001.

SSL seem to have a problem collecting their debts. Where the industry average is in



debtor-creditor equilibrium of roughly 82 days over the last five years, SSL's five- year debtor days are nearly 20% higher than the creditor days. Unless there are lucrative credit agreements with customers, this may run the company into liquidity problems through incurring substantial bad debts. In this case, appropriate provisions

should be made.

Corporate Finance Ratios

SSL	10.5	Z. L. Carlotte	OF BRIDE N	H LOW WAY	Name and Address of the Owner, where the Owner, which is the Owner, where the Owner, where the Owner, where the Owner, where the Owner, which is the Owner, which i	La Company
	10.0		9.45	7.4	7.1	8.29
Sector	13.5	12.65	5.27	6.03	5.82	8.65
SSL	7.13	-9.19	-4.59	-5.65	-6.9	-3.84
Sector	0.43	0.5	1.52	1.87	1.95	1.25
000	SL	SL 7.13	SL 7.13 -9.19	SL 7.13 -9.19 -4.59	SL 7.13 -9.19 -4.59 -5.65	SL 7.13 -9.19 -4.59 -5.65 -6.9

At a five-year interest cover average of 8.29, SSL appears to be in a strong position to service its long-term debts. However, the steady decline in interest cover over the last five years should signal the management to take out new loans only if the future growth rates for profit before interest indicate a go-ahead. Nevertheless this decline should not concern the investor as SSL's interest cover is still above the sector average.

The borrowing ratio depicts the relationship between long-term debt and capital employed. Since long-term debt is £244.2m and total capital employed is only £69.4m for 2000. Since Datastream deducts *intangibles* (GBP77.6) from *capital and reserves*

(GBP69.4) in the denominator, this ratio is negative. Although the sector average is positive, investors should also understand that SSL's business nature resembles more a pharmaceutical company than a healthcare company.

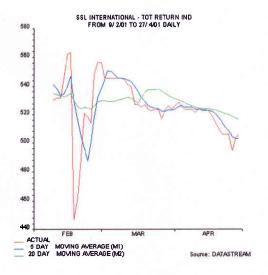
LIQUIDITY		Feb-96	Feb-97	Feb-98	Feb-99	Mar-00	Mean
Working Capital	SSL	1.01	1.18	1	1.85	1.33	1.27
(times)	Sector	1.36	1.39	1.32	1.34	1.37	1.40
Quick Ratio	SSL	0.79	0.94	0.74	1.38	1.01	0.97
(times)	Sector	0.9	0.95	0.88	0.90	0.94	1.1
		V-1				source: 1	Datastrear

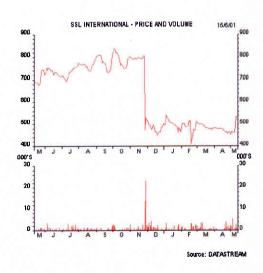
Regarding short-term liabilities, the working capital ratio shows that current assets cover short-term creditors 1.33 time in 2000. This implies that the company has sufficient liquid resources to cover its current liabilities. At 1.33 times, SSL's current ratio is nearly the same as the 1.37 times sector benchmark for the year 2000, giving no cause for concern.

The quick ratio only takes into account the firm's most liquid resources (i.e. debtors and cash). At around 'one', this ratio indicates that current liabilities could be met entirely by using the most liquid resources only. Again, this should build up confidence among investors that SSL is liquid and able to meet its current liabilities comfortably. However, care should be taken that debts are collected in full so that the ratio will not fall below 'one' for the years to come.

7.10 Technical Analysis

The share price does not seem to have recovered from the disappointing announcement of excessive merger costs and stocking problems. It has been traded some 300 points below the pre-announcement price over the last six months. Liquidity in the stock has





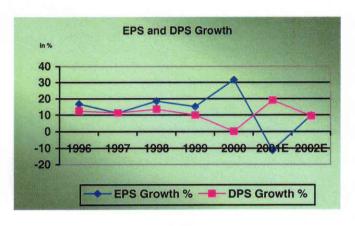
been consistently low and technical analysis supports a selling position, after the five day moving average crossed the twenty-day average in a downward slope.

7.11 Investors Ratios and Financial Forecast

Year to end Dec	norm Pre-tax Profit (m)	EPS (p)	CFPS (p)	DPS (p)	DIV. COVER (x)	DIV. Yield (%)	EV/EBITDA (x)
1999	56.4	37.5	17.6	11.0	3.41	n/a	n/a
2000	120	49.3	8.65	11.0	4.47	2.32	9.9
2001E	106	43.8	n/a	13.1	3.33	2.76	12
2002E	118	48.1	n/a	14.4	3.34	3.02	10.7

Source: Datastream

Profits and EPS in 2001 and 2002 are off the high growth trend seen in previous years as the glut of condoms is expected to dent activity and put price pressure on the firm's



products. At 3.02, dividend yield is expected to be remarkably high in 2002. Combined with a PER of 10 and an EV/EBITDA of 9.9, SSL also resembles a value company. Dividends are covered more than three times and DPS are expected to grow at a cumulative thirty per cent over the next two years. After

2001, when stocking problems will have lost their negative effects on earnings, EPS is thought to recover by 20 per cent. More optimistic estimates predict EPS growth to 49.8p by 2002.

7.12 Conclusive Remark

SSL is currently solving the problems that led to the steep decline of its share price in 2000. The managers responsible for stocking problems and subsequent profit warnings have been asked to step down and new, high-calibre directors have been appointed. Many problems stem from trying to grow to quickly and it may take some time before confidence in the stock is fully restored. However, at a growth rate of 8 per cent, the underlying business is strong and the newly appointed finance director brings in stability. Given these recovery prospects, investors should neglect short term selling indications as given by the technical analysis and buy shares in SSL International.

Chapter 8

Conclusion

The analysis of the UK Healthcare Sector has revealed a real alternative to high growth sectors, such as Telecommunications or Technology. Although growth rates are not expected to rocket like TMT stocks in the March 2000 hype, investments in this sector do provide stability as well as higher than average returns. These could come in either form, through capital gains or exceptionally high dividend payments.

The external environment of the UK Healthcare sector is extremely promising, with favourable demographic trends, market growth and government involvement contributing towards high expected growth rates.

A substantial part of the analysis was to find out if any company, of any size, pursuing any activity is positioned well enough to take advantage of these trends. Surprisingly enough, the two small cap companies seem to be positioned best. They typically possess superior management and are occupying niche markets, where there is little or no competitive pressure. Furthermore, these two firms are restricted to the British market and are therefore able to accurately forecast demand for highly specialised services. In contrast, the two international players, Nycomed Amersham and SSL International, seem to have problems identifying changes in demand and are partly exposed to mismanagement, with adverse effects on confidence in the individual stocks. However, their production diversification in low cost markets and distribution strategies in high turnover countries shield them from economic slowdowns in individual market places.

Another factor, which makes this sector extremely attractive, is the low exposure to cyclical turbulence. The actual level and the growth rate of demand for Healthcare products and services is typically independent from the prevailing economic situation.

This analysis concludes with a buying recommendation for Nestor Healthcare, Nycomed Amersham and SSL International. Particular emphasis was made on the individual positioning strategies in order to capture a big as possible size of the growing UK and world Healthcare market. The companies analysed are either well positioned already or are in the process of repositioning. The one 'hold' recommendation is the result of recent takeover events in Community Hospitals Group.

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