

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.



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.

Contents

Abstract	2
Acknowledgements	3
1 Economic Environment	6
1.1 The Economic Situation in the UK	6
1.2 The Economic Situation in the US	6
1.3 The Economic Situation in Europe	7
1.4 The Economic Situation in Asia	8
2 The External Healthcare Environment in the UK	9
2.1 General Economic Statistics	9
2.1.1 Statistics of the Individual Markets	9
2.1.2 Members of the FTSE All Share Health Sector	10
2.2 Political Factors	11
2.3 Social Factors	12
2.3.1 Ageing Population	12
2.3.2 Change in Lifestyle	13
2.4 Technological Factors	14
2.4.1 The Disclosure of the Human Genome	14
2.4.2 Outsourcing	15
3 Stock Market Conditions	16
4 Investment Analysis of Community Hospitals Group Plc	17
4.1 General	18
4.2 Cyclicity	18
4.3 Acquisition Talks	18
4.4 Competitors	19
4.5 Strategy	19
4.6 Turnover and Profit Analysis	20
4.7 Ratio Analysis	21
4.8 Technical Analysis	25
4.9 Investors Ratios and Financial Forecast	26
4.10 Conclusive Remark	26
5 Investment Analysis of Nestor Healthcare Group Plc	27
5.1 General	28
5.2 Recent Events	29
5.3 Cyclicity	29
5.4 Competitors	30
5.5 Strategy	30
5.6 Turnover and Profit Analysis	31
5.7 Divisional Analysis	32
5.8 Ratio Analysis	33
5.9 Technical Analysis	35
5.10 Investors Ratios and Financial Forecast	36
5.11 Conclusive Remark	36

6	Investment Analysis of Nycomed Amersham Group Plc	37
6.1	General	38
6.2	Recently...	39
6.3	Competitors	40
6.4	Strategy	41
6.5	Cyclicality	41
6.6	Turnover and Profit Analysis	42
6.7	Divisional Analysis	42
6.8	Geographical Analysis	42
6.9	Ratio Analysis	43
6.10	Technical Analysis	46
6.11	Investors Ratios and Financial Forecast	47
6.12	Conclusive Remark	48
7	Investment Analysis of SSL International Group Plc	49
7.1	General	50
7.2	Cyclicality	50
7.3	Brand Portfolio	51
7.4	Strategy	52
7.5	Recent Problems	52
7.6	Geographical Analysis	53
7.7	Divisional Analysis	54
7.8	Turnover and Profit Analysis	54
7.9	Ratio Analysis	55
7.10	Technical Analysis	58
7.11	Investors Ratios and Financial Forecast	59
7.12	Conclusive Remark	59
8	Conclusion	60

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.

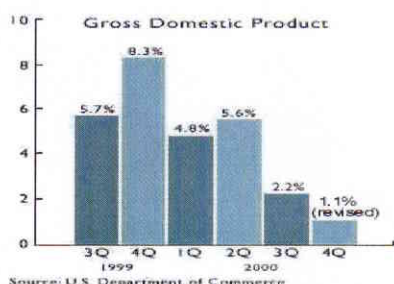
With growth of just 0.3 per cent, first-quarter figures of UK GDP growth were disappointingly weak and 0.1 per cent less than predicted. This slowdown was mainly caused by a considerable weakness on the industrial side as sectors with strong international links were adversely influenced by a slowdown 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

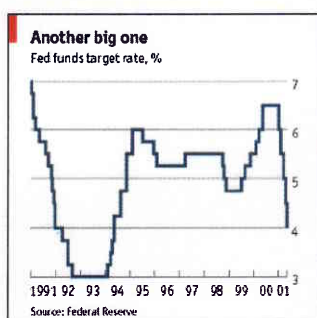
Towards the last two quarters of 2000, concerns about a slowing economy were sparked



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 run-down 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 Euro-zone 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 overshoot 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.

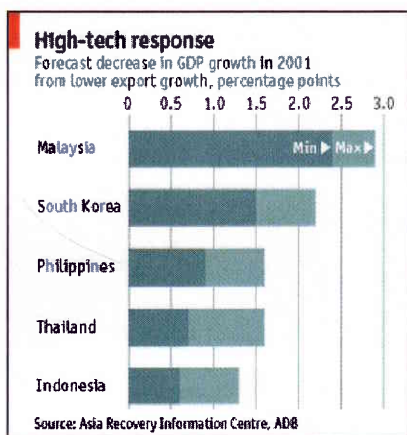
The most influential driver of this interest rate dilemma is Germany, where growth forecast were revised down from 2.75 per cent to about 2 per cent this year. In contrast, France reported growth forecasts of 2.9 per cent for 2001. This demonstrates that even the strongest members of the Union are still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



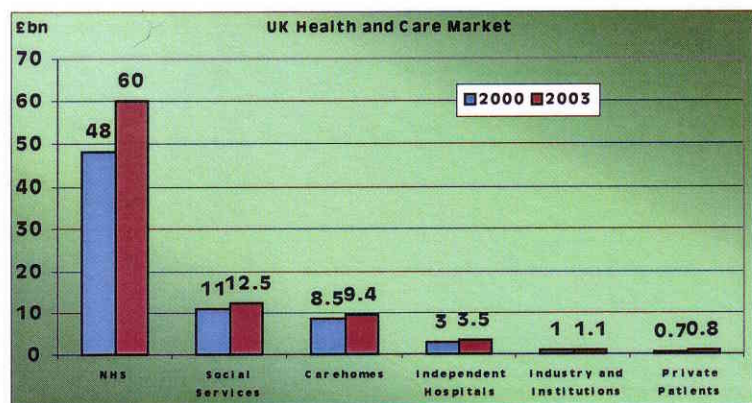
exports, and hence Asian GDP growth slowed as US economy went into recession. In addition to the export slowdown, weak domestic demand endangers the region's recovery prospects. Adding to the problems are the region's banks, which are still confronted with bad loans and are reluctant to lend to local 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

<HELP> for explanation, <MENU> for similar functions. N248Msg:HELP DESK
Cancel: Screen not saved

FAHLTH Member Weightings Page 1 / 1
FTSE ASX HEALTH INDEX * capitalization weighted index *

17 Members

Rank	Code	Company Name	Weight (%)
1)	AUN	LN Alliance UniChem	15.237 %
2)	ASD	LN Axis-Shield Plc	1.321 %
3)	BPK	LN Bepak Plc	1.304 %
4)	BII	LN Biocompatibles I	3.379 %
5)	CUK	LN Care U.K.	1.187 %
6)	CHP	LN Community Hospit	1.975 %
7)	DPH	LN Dechra Pharmaceu	.761 %
8)	GYG	LN Gyru Group Plc	1.082 %
9)	HEC	LN Health Clinic	.789 %
10)	HTL	LN Huntleigh Techno	1.320 %
11)	MLS	LN Medical Solution	.632 %
12)	MDY	LN Medisys Plc	2.545 %
13)	NSR	LN Nestor Healthcar	3.589 %
14)	NAM	LN Nycomed Amersham	30.981 %
15)	SNZ	LN Smith & Nephew P	24.755 %
16)	SSL	LN SSL International	7.348 %
17)	WHM	LN Whatman Plc	2.396 %

Copyright 2001 BLOOMBERG L.P. Frankfurt: 69-320410 Hong Kong: 2-977-8000 London: 207-330-7500 New York: 212-318-2000
Princeton: 609-279-3000 Singapore: 65-212-1000 Sydney: 2-9777-9606 Tokyo: 3-3201-8200 Sao Paulo: 11-3048-4500
1369-968-0 07-May-01 23:25:48

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

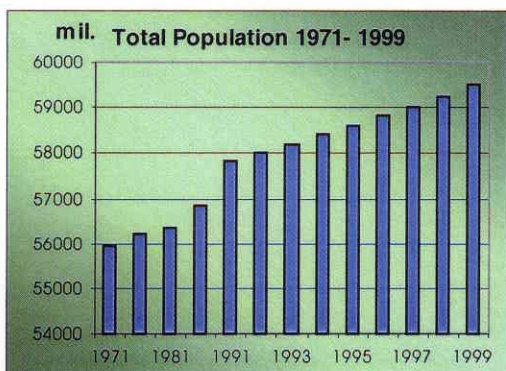
As Britain is currently preparing for General Election, it comes as no surprise that political parties throw in their last resources in order to gain voters' support. Education, Social Welfare but also the provision of medical services is high up on the political agenda. Although it is recognised as 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.

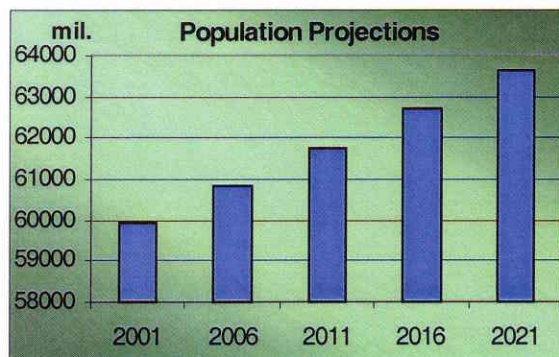
The increase in patient activity in the private sector associated with this transitional stage of NHS-restoration is more than just a short- or medium term phenomenon. The 2001 budget considerations are merely sufficient to accommodate for current problems. However, demographic developments in the UK 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.



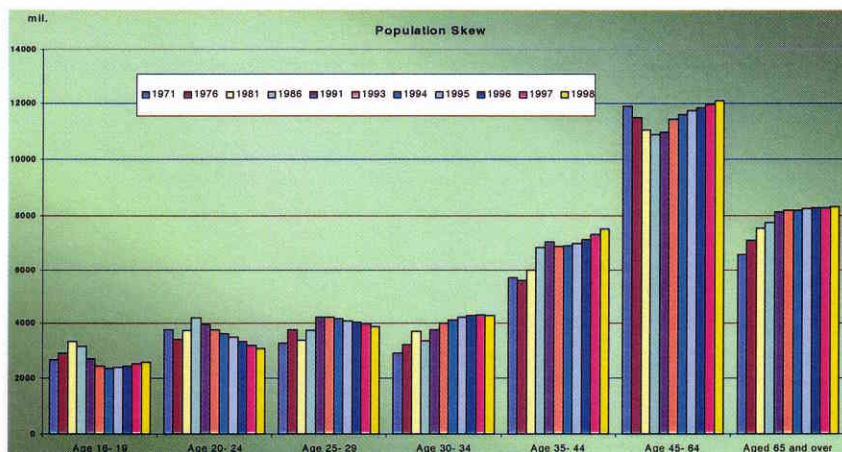
Source: Statbase



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