

## Can Discovery pull it off? – Financial Mail (9 September 2021)

Stephen Cranston | Financial Mail | 9 September 2021

DISCOVERY, the dominant medical aid administrator in SA, has certainly played a visible role in the fight against the pandemic. For a start, its nine large vaccination sites each process thousands of people a day. And it has now taken the moral high ground by insisting that all its employees be fully vaccinated by the end of this year. Yet the group's share price, at R123, is 22 percent lower than its 12-month high, and almost exactly flat over a one-year period. Justin Floor of PSG Asset Management said the market is anxious that the government will pull the rug from under its core Discovery Health business with a centralised National Health Insurance. And Floor acknowledged that many investors were put off by the complexity of the company. Yet Discovery continues to demonstrate, with deft PR, the scope for partnership between the public and private sectors. And it's not as if it's in bad shape, either. In the final results for the year to June 2021, Discovery Health enjoyed the benefits of scale from its large member base. It increased revenue by 5 percent to R8.8-billion, but parlayed that into an operating profit increase of 7 percent to R3.4-billion, even as it delayed annual fee increases by six months to help clients find their feet during the pandemic. Group CEO Adrian Gore said Discovery Health in some ways benefited from the pandemic as there was a sharp reduction in discretionary admissions that the medical scheme would have covered: for example, endoscopies were down 27 percent and tonsillectomy admissions fell 61 percent. Discovery Health accounted for 53 percent of the group's operating profit in the past year, yet the group comfortably retains a premium status in the life insurance sector. Avior Capital Markets head of research, Warwick Bam, said Covid slowed the growth of all businesses in the group but has only really severely affected Discovery Life in SA, which paid out R6.2-billion in Covid claims, about half of that in the June 2021 financial year. Vitality Life in the UK was, in contrast, a strong performer. While Discovery Life increased its Covid provisions from R2.16-billion to R2.69-billion over the financial year, Vitality Life's fell from £28.8-million to £5.4-million, mainly because of the much earlier and more comprehensive vaccination campaign in Britain.

### Outstanding performer

But the outstanding performer in the Discovery Group was Ping An Health, in which Discovery's share of earnings increased by 126 percent to R411-million. It now contributes as much as the entire Vitality Group, which franchises the Vitality rewards architecture across the globe. Bam said that unlike the technology groups such as Alibaba and Tencent, in which the Chinese state would like to see reduced profit, the insurance sector is well aligned with the ambitions of the state. He said a shrinking workforce needs to support a rapid rise in retirees. The need for healthcare insurance and health infrastructure is a priority for the Chinese state. And he believes that investors should not be concerned about the proposed R1.5-billion capital raise to maintain Discovery's 25 percent shareholding in Ping An Health: only 30 percent will have to be allocated to increased regulatory capital, while 70 percent of the potential rights issue can be used to expand the business. Discovery has made a success of all its new ventures, except for Destiny Health in the US in the 2000s. Some investors were disappointed that Discovery did not pay a final dividend, but Floor argues that as long as management can make money ahead of the cost of capital, PSG would prefer that it keeps the money and continues to reinvest. Discovery is certainly channelling money into new sectors, most recently entering car insurance in the UK through a joint venture with French company Covea. Floor

also believes that while it is unlikely to start banks outside SA, Discovery could consider licensing its banking technology internationally to challenger banks entering new markets.

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