

Medibank 2019 half year results

A stronger Medibank delivers uplift in customer advocacy and policyholder growth

CEO COMMENTARY

“This result demonstrates that Medibank’s core business continues to get stronger.

“Our focus on improving customer outcomes has driven a strong uplift in customer advocacy and delivered growth in resident policyholders of 6,400 in the first half, compared to a loss of 4,200 in the previous corresponding period.

“This is a clear sign of the health of the company and reflects the success of our dual brand strategy, critically the ongoing strong recovery of the Medibank brand and improved customer retention.

“It is pleasing to see that by making decisions that are in the best interests of our customers, we have strengthened our company. We have had strong improvement in customer advocacy and our net promoter score (NPS). Customer NPS gap to peers and Service NPS both continued their positive trajectory. Medibank brand preference was also the highest it has been since the IPO in 2014 and our share of ombudsman complaints remained well below market share.

“This gives us confidence that we have the right strategy and team in place to grow the core business, while continuing to transform Medibank into a broader health services company.

“There is a meaningful opportunity for Medibank Health to become a more significant contributor to Medibank, both standalone and in the way we manage our existing claims expense. This is through accelerated growth in health and care services in the home, reform of existing care pathways, an increased role for telehealth, and delivery of chronic disease management and mental health services.

“We have also set a new milestone to organically replace the full year 2018 operating profit of Garrison by full year 2022. This will be achieved through increased scale and capability in our existing businesses and cost-out within Medibank Health of \$8 million.

Key numbers

\$2.7b

benefits paid to customers

\$207.7m

Group net profit after tax

6,400

new resident policyholders since 30 June 2018

5.7 cents per share

interim dividend fully franked

22.3%

Medibank brand preference, the highest since the IPO in 2014

Financial summary

Group NPAT of \$207.7 million,
down 15.4% from \$245.6 million

Strong improvement in customer advocacy,
Medibank Service NPS of 24 (+8) compared to the prior period and ahm Service NPS was 35 (+5) over the same period

Group operating profit \$293.0 million, up 2.4%

Health Insurance

- Operating profit \$281.5 million, up 1.5%
- Premium revenue growth 2.1%
- Management expense ratio 8.5%, down from 8.6% in first half 2018

Medibank Health

Operating profit up 14.7% to \$28.9 million or up 38.5% to \$12.6 million on an ongoing basis

Net investment income \$4.1 million,
down from \$59.7 million in first half 2018 in line with relevant indices

Investor briefing

The investor briefing will be held today at 9.30am AEDT. The investor presentation and webcast will be accessible on Medibank’s [investor centre](#). A video interview with CEO Craig Drummond is available on our [newsroom](#).



“We see the upcoming reform as a real opportunity to deliver better outcomes for our customers. Designed to improve transparency and affordability across the sector, Medibank will adopt all the Federal Government’s optional reforms including young adult discounts, higher hospital excesses and rural and regional travel allowances – because it is the right thing for our customers.

“While the operating environment in full year 2020 is likely to be challenging, we are confident with our plans leading into the likely lower rate rise environment and see future reform as critical to promoting industry sustainability. In this environment our intention is to aspire for stronger growth in volumes at a reasonable margin, while retaining ongoing tight control of our management expenses.

“We want a system that is more affordable, easier to use, and creates greater customer value. We are working hard within our business to achieve this, but these challenges cannot be solved by private health insurers alone.”

CRAIG DRUMMOND
CHIEF EXECUTIVE OFFICER

Dividend

The Board has declared an interim dividend of 5.7 cents per share, fully franked. The interim dividend represents a 67% payout ratio of underlying NPAT. For the full year, we expect the payout ratio to remain at the top end of the targeted 70% to 80% range.

2019 interim dividend dates

Ex-dividend date		Tuesday March 2019
Payment date		Thursday March 2019

PERFORMANCE IN DETAIL

Group

Group NPAT decreased 15.4% to \$207.7 million (1H18: \$245.6 million). This was largely due to net investment income which fell by \$55.6 million, driven by lower equity and credit market returns.

Health Insurance

Health Insurance operating profit increased by \$4.2 million to \$281.5 million, underpinned by policyholder growth.

Health Insurance premium revenue was up 2.1% to \$3,240.3 million. Both Medibank acquisition and retention improved, with the improvement in retention supported by the launch of our customer priority program. Further improvement is expected following the launch of the Live Better App in the coming months.

ahm’s customer proposition of being simple, easy and affordable continues to resonate with the market and this helped deliver 10.7% policyholder growth in the last 12 months. We continued to invest in our direct acquisition channels, which accounted for 46% of all new ahm customers in the six months to December 2018.

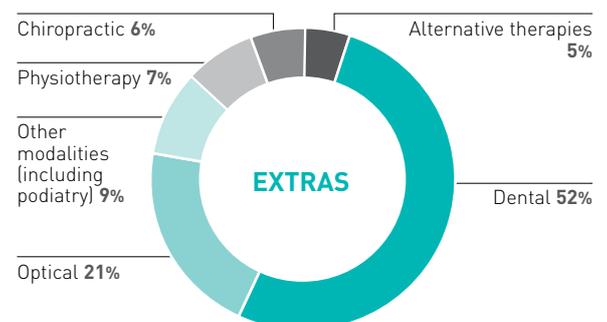
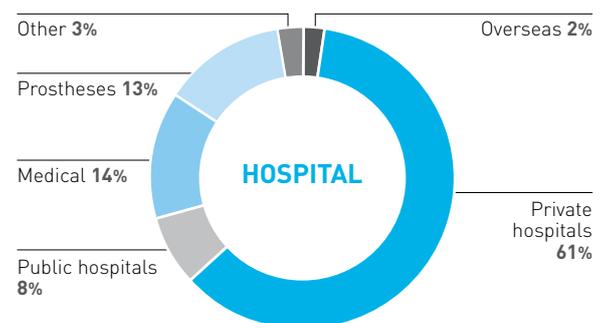
Health claims rose by 2.3% to \$2.7 billion for the half year, reflecting a 1.7% increase in gross claims, and a 50% reduction in risk equalisation receipts. The reducing reliance on risk equalisation receipts is primarily due to the ongoing growth in ahm customers, who are generally younger and hold a lower level of cover.

Management expenses were essentially flat at \$274.3 million, with the management expense ratio (MER) improving from 8.6% to 8.5%.

Underlying cost control and the ongoing benefit of our productivity program resulted in operating expenses falling by \$3.0 million or 1.3%. Depreciation and amortisation increased by \$3.9 million following the commissioning of the new payroll, procurement and finance systems in November 2017.

Medibank is on track to deliver \$20 million in productivity savings in full year 2019 with another \$20 million expected in full year 2020.

COMPOSITION OF CUSTOMER CLAIMS



Medibank Health

Medibank Health revenue rose by 11.1% to \$339.0 million reflecting the inclusion of Home Support Services (HSS) which was acquired in August 2018, with operating profit increasing by 14.7% to \$28.9 million. Excluding discontinuing operations, specifically the Garrison contract which will cease on 30 June 2019, Medibank Health revenue increased by 26.6% to \$108.9 million, which includes 11.7% organic growth. On the same basis, operating profit increased by \$3.5 million or 38.5% to \$12.6 million, reflecting the contribution from HSS and our Diversified Insurance business. The management expense

ratio improved by 510 basis points, with \$8 million of expense savings expected post the Garrison contract exit.

Investment income

Net investment income was down from \$59.7 million to \$4.1 million, in line with relevant indices. Consistent with previous practice, to determine the dividend for the period, we have adjusted net investment income to normalise for the impact of the negative market returns. In the first half, underlying NPAT reflects a normalisation adjustment to reported investment income of \$35.8 million or \$25.1 million after tax.

Capital

Health Insurance related capital as at 31 December 2018 was \$905.6 million, representing 14.0% of premium revenue, which is at the top end of the Board's stated target range of 12.0% to 14.0%. In November 2018, APRA announced its intention to harmonise the Health Insurance capital framework with the Life and General Insurance Capital Standards (LAGIC) framework. APRA has indicated it will commence an industry consultation process in March 2019. Subject to this, Medibank will look to provide an update on its capital management settings at the full year 2019 earnings release.

SUMMARY OF FINANCIAL RESULTS

Six months to 31 December (\$ million)	1H19	1H18	Change
Group:			
Revenue	3,560.9	3,467.0	2.7%
Health Insurance operating profit	281.5	277.3	1.5%
Medibank Health operating profit	28.9	25.2	14.7%
Segment operating profit	310.4	302.5	2.6%
Corporate overheads	(17.4)	(16.4)	6.1%
Group operating profit	293.0	286.1	2.4%
Net investment income	4.1	59.7	n.m.
Amortisation of intangibles	(3.8)	(3.5)	8.6%
Other income/(expenses)	(2.9)	3.8	n.m.
Profit before tax	290.4	346.1	(16.1%)
Income tax expense	(82.7)	(100.5)	(17.7%)
Net profit after tax (NPAT)	207.7	245.6	(15.4%)
EPS (cents)	7.5	8.9	(15.4%)
Dividend per share (cents)	5.70	5.50	3.6%
Health Insurance:			
Premium revenue	3,240.3	3,175.1	2.1%
Net claims expense (incl. risk equalisation)	(2,684.5)	(2,624.6)	2.3%
Gross profit	555.8	550.5	1.0%
Gross margin (%) ¹	17.2%	17.3%	(10bps)
Management expenses	(274.3)	(273.2)	0.4%
MER (%) ¹	8.5%	8.6%	(10bps)
Operating profit	281.5	277.3	1.5%
Operating margin (%) ^{1,2}	8.7%	8.7%	-

1 Includes Australian residents, OSHC and OVHC. The gross margin for Australian residents only was 16.8% in 1H18 and 16.5% in 1H19, the MER for Australian residents only was 8.4% in 1H18 and 8.1% in 1H19, and the operating margin for Australian residents only was 8.4% in 1H18 and 8.4% in 1H19.

2 The reported result includes the benefit of a \$10.3 million provision release relating to the FY18 provision. By way of comparison, in 1H18, the benefit relating to the FY17 release was \$33.8 million.

OUTLOOK

- Expect flat overall private health insurance market volumes to persist.
- On the current policyholder trajectory, expect to see Medibank brand volumes stabilise by the end of full year 2020.
- Hospital and extras utilisation growth is expected to remain subdued for the remainder of full year 2019.
- Management expenses for full year 2019 are targeted to be modestly above those recorded in full year 2018.
- Expect to provide an update on additional productivity initiatives at the full year 2019 result.
- In the short to medium term, we see the potential to make 1-2 more small acquisitions to build our health services capability.
- We will consider acquiring a PHI business in a stressed operating environment.
- While the operating environment in full year 2020 is likely to be challenging, we are confident with our plans leading into the likely lower rate rise environment and see future reform as critical to promoting industry sustainability. Our intention is to aspire for stronger growth in volumes at a reasonable margin, while retaining ongoing tight control of our MER.

PRIVATE HEALTH INSURANCE REFORMS

NEW PRODUCT TIERS



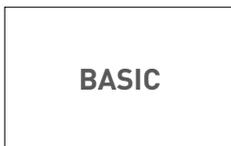
GOLD



SILVER



BRONZE



BASIC

Medibank has begun the process of delivering on the next phase of the Federal Government's private health insurance reforms. Product standardisation is compulsory, with Medibank and ahm having new hospital cover products under the Gold, Silver, Bronze and Basic product tiers from 1 April 2019. Existing products will transition over the following 12 months with a focus on making this process as simple as possible for customers. The changes are being made so the products comply with the Government's reform requirements and no material ongoing financial impact on the business is expected.

Insurers have the option of introducing discounts for young adults, higher hospital excesses and rural and regional travel allowances. Medibank is adopting these reforms because it is the right thing for customers. Approximately 150,000 Medibank and ahm customers will have up to the maximum 10% young adult discount applied to

their policy from 1 April. This important reform is designed to improve affordability among younger Australians. While there will be a small revenue impact from this important reform, it is expected to be largely offset by greater participation and retention. Higher excesses will also be made available on most products from 1 April, increasing the standard maximum \$500 excess for singles to \$750 and from \$1,000 to \$1,500 for families and couples. Higher excess provides a lower premium for customers. Lower premium revenue from higher excess reform is expected, however this is expected to be partially offset by policyholder growth and improved customer retention.

There will be a one-off reform implementation cost of approximately \$10 million in full year 2019 (included in the Health Insurance management expenses). The full year 2019 investment slate has been re-prioritised to offset the majority of this additional cost.

FURTHER ENQUIRIES

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All figures are A\$ unless stated otherwise. A number of figures, amounts, percentages, estimates, calculations of value and fractions are subject to the effect of rounding. Accordingly, the actual calculations of these figures may differ from figures set out in this document. Also, some balances subject to rounding, may not add consistently.