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# EDITED TRANSCRIPT

SHL.AX - Half Year 2020 Sonic Healthcare Ltd Earnings Call

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## CORPORATE PARTICIPANTS

**Christopher David Wilks** *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

**Colin Stephen Goldschmidt** *Sonic Healthcare Limited - CEO, MD & Executive Director*

**Paul J. Alexander** *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

**Stephen Fairy**

## CONFERENCE CALL PARTICIPANTS

**Andrew Goodsall** *MST Marquee - Healthcare analyst*

**Chris Cooper** *Goldman Sachs Group Inc., Research Division - Research Analyst*

**David A. Low** *JP Morgan Chase & Co, Research Division - Research Analyst*

**David Bailey** *Macquarie Research - Research Analyst*

**Gretel Janu** *Crédit Suisse AG, Research Division - Research Analyst*

**John Deakin-Bell** *Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand*

**Lyanne Harrison** *BofA Merrill Lynch, Research Division - VP*

**Megan J. Kirby-Lewis** *Morgan Stanley, Research Division - Research Associate*

**Saul Hadassin** *UBS Investment Bank, Research Division - Executive Director & Research Analyst*

**Steven David Wheen** *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

## PRESENTATION

**Operator**

Welcome, again, to the Sonic Healthcare half year results presentation.

I will now hand you over to your presenter, Dr. Colin Goldschmidt. Go ahead, please.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Thank you very much, Darren, and good morning, ladies and gentlemen. Welcome to Sonic Healthcare's results presentation for the half year ended 31 December, 2019.

As Darren mentioned, my name is Colin Goldschmidt, CEO of Sonic Healthcare. And joining me here in Sydney today are 3 of my colleagues: Chris Wilks, Sonic's CFO; Paul Alexander, Sonic's Deputy CFO; and Dr. Stephen Fairy, Sonic's Chief Medical Officer. I plan to take you through the results presentation. And then, after the presentation, the 3 of us -- or the 3 will join me to discuss your questions.

Before commencing the formal presentation, I'd like to just make a few comments about the coronavirus outbreak or the 2019 novel coronavirus as it's more formally known. And I'd like to make these comments particularly because Sonic Healthcare is a key provider of essential medical services to large numbers of communities around the world.

All Sonic divisions, and that's on a global basis, have been working extensively with local and national health authorities to support and implement all the necessary pandemic control measures. Our teams of people, that's clinical teams, operational teams, have responded rapidly in order to ensure the continuity of our own clinical services.

And to that end, we've done a bunch of things like providing protection for our frontline employees and customers, providing patients and customers with access to testing for coronavirus. We've also provided reliable and up-to-date information and guidance to our staff, to our patients and customers. And we've also made sure that supply lines and logistics are uninterrupted during this period.

It's an interesting fact, just to know that our lab in Bremen, that's Laboratory Bremen in Germany, was the first lab in Germany to establish a validated PCR test for the coronavirus, which has now been shared by 2 other of our labs in Germany. And we believe that this was one of the very first labs in the whole of Europe to begin using a validated test for the virus. Now depending on circumstances, the coronavirus testing can be rapidly established in other Sonic labs, including in our Australian laboratories and we'll play that one as things pan out into the future.

And just a final comment to let everyone know that there's no indication that the coronavirus outbreak has impacted our business in any way, either negatively or positively.

So if I could commence the formal presentation. Going to Slide 3, which is a slide about our headlines. And first up on that headline list just a few points about our guidance. We are today reaffirming our guidance for the full financial year 2020, and that's after 7 months of trading. Our guidance, as you remember, which we issued in August of last year, is for 6% to 8% constant currency EBITDA growth. And so for the first half of the year, our EBITDA growth came in at 11% at constant currency level.

This is a particularly strong number, which was augmented by the Aurora Diagnostics acquisition, which was completed on the 30th of January 2019. So just as a reminder, this first half result includes a full 6 months benefit of Aurora, whereas the second half in train now will only have 1 month of the Aurora acquisition benefit because the deal actually cycled on 30th of January this year.

Another point is that the impacts of both Aurora and the PAMA Medicare fee cuts in the U.S. were both factored into our guidance. And so there is no change to our expectations after the 7 months that we've traded so far.

Another point, and that's the -- starting the second major bullet point just for noting is that this is our first reporting period, which incorporates the new lease accounting standard, AASB 16, which, as you know, requires the capitalization of operating leases to the balance sheet, with amortization over the term of the lease and with some associated P&L changes.

So essentially, what this means is that the rental expense line on the P&L largely disappears and is replaced or compensated by an increase in amortization expense, which is below the EBITDA line. AASB 16 has particular relevance and significance for a company like Sonic because we operate so many property leases. In our industries, that's the pathology industry or medical laboratory industry, in radiology and primary care, we use extensively patient centers. So in particular, we operate large numbers of leased collection centers for pathology specimen collection. We also operate large numbers of spaces for laboratories themselves, for imaging centers and for GP medical clinics.

And incredibly, all up, we have over 4,500 leases. So you'll get a sense of the magnitude of the task involved in order to transition to this new accounting standard. And so I guess, this would be a good time for me to acknowledge the incredible work completed by the Sonic finance team, assisted by Sonic's finance staff throughout the world and other staff in order to bring this essentially mammoth project to a successful completion.

So just looking at those headline numbers. Our revenue growth came in at 15% at actual currency level and 12% at constant currency level, and you'll see the Delta there is about 3%, which is due to foreign currency tailwind.

Our organic revenue growth came in at 5% on a constant currency basis. And the underlying EBITDA number, which I mentioned, was 11% at constant currency level and 14% at actual currency level. And net profit growth was at similar metrics. Now pleasingly, we did achieve margin accretion in both the laboratory and imaging segments.

And the next point, just 1 year post acquisition, the Aurora Diagnostics acquisition is tracking well and performing to expectation. And I'll discuss a bit further the interim dividend for FY 2020, which has been declared at $0.34 per share.

If we move on to Slide 4, the table on this slide presents a summary of Sonic's headline financials for the half year. Including in the far right column, that's with the red heading, our headline numbers expressed under AASB 16 for the first time. And you'll see there that the most striking features to change to Sonic's EBITDA number, which for the half increases by around $150 million.

So if we look at the full year expectation, we're anticipating that EBITDA will increase by around $300 million for the full year under this standard. Also, just a reminder that the numbers in this table are expressed in actual currency in Australian dollars.

Just a few further comments about the table. Our actual revenue growth for the half came in at 15%, as mentioned, and the organic growth rate was 5% for the half. And these are pleasing numbers for us, especially in the face of some of the headwinds that we're experiencing with fees in the U.S. and the choppiness in Germany associated with the EBM fee quotas, which we can talk a bit about later.

Also, very pleasingly, we achieved 10 basis points of margin accretion in the global laboratory division. And this is a very good result, given the headwind that we're experiencing in the U.S., in particular, in terms of top line.

The Imaging division continues to perform strongly and achieved 40% -- 40 basis points of margin accretion in the half. The net profit number, the growth of 15% was in line more or less with our growth in revenue. Earnings per share, however, was impacted by the shares issued as part of the equity raise associated with the Aurora acquisition, which does give us balance sheet flexibility for future growth.

And finally, another point, the lower than usual growth in cash generation from operations and the conversion of EBITDA to gross operating cash flow is due to timing of creditor payments in the period, and we do expect this to reverse favorably in the second half of the year. And I guess I should just mention a final point about the FX tailwind. As I mentioned, it comes in at about 3% at both revenue and earnings levels. And just to give you the absolute numbers, the FX tailwind for the half was worth $83 million of revenue and about $13 million of EBITDA.

If we could turn to Slide 5. And this is really for information more than commentary. The first bullet point is essentially a reminder of our first year guidance, which is unchanged from August of last year when it was issued. And then the second major bullet point, we're reaffirming our guidance of 6% to 8% EBITDA growth at constant currency level.

Going to Slide 6, which we show in the table, a $0.01 increase in the interim dividend for FY 2020, which is a 3% increase over the interim dividend last year. The dividend will be franked to 30% and the record and payment dates are 11 and 25 March 2020, respectively. The dividend reinvestment plan is to remain suspended, particularly in light of the major equity raise as part of the Aurora acquisition.

Now if we go to Slide 7, where we show our usual pie chart. In statutory revenue, Australian dollars, split by country and major division, and just to note, this pie does not include small impacts from interest income and AASB 16. At the full year result in August last year, we did flag that Sonic's U.S. division would move clearly into the #1 position as our largest division in FY 2020, and you can see this now clearly on the chart already for the half year.

And just a few other observations about the chart, particularly when you compare it to a year ago. First of all, the pie itself has increased by 15%. That's our actual currency revenue growth. And then just of interest of our total revenue of $3.34 billion for the half, 63% of Sonic's revenue is now international, with 37% in Australia. 5 years ago, that split was around 50-50, Australia to International. So you can really see a trend that is set to continue well into the future.

If you look at just our laboratory division, that's the pathology segment by taking out Imaging and SCS, 73% of Sonic's revenue is international, with 27% Australia. So just for the laboratory division, the split is about 3/4 to 1/4, as we speak right now. And as mentioned, we certainly expect the International division to keep growing, and its growth will outstrip the Australian growth as we capitalize on the greater opportunities in M&A and contracts and joint ventures in the U.S.A., U.K. and Europe.

Now moving on to some commentary on our divisions. First of all, the U.S.A., where revenue came in at 45% in Australian dollars, in actual dollars, and 37% on a constant currency basis. Obviously, that number is big because it includes the Aurora acquisition. Our organic revenue growth came in at 2% on a constant currency basis, and it was impacted by the PAMA Medicare fee cuts to the tune of about 1.3% of revenue. So I guess, ex-PAMA, our organic growth rate would be 3.3% for the half.

About the Aurora acquisition, as I mentioned, the business is performing to expectation, and we are well underway with a major cost and revenue synergy program. The cost synergies include things like procurement, IT and administration. And as flagged previously, the revenue synergies include things like cross-sell between anatomical pathology and clinical pathology, but we also get revenue synergies in oncology and molecular pathology offerings. And also in ThyroSeq, which is a new test, which I'll discuss in a moment.

And just for interest, an example of cross-sell is that, at the moment, we -- one example is that we are referring dermatopathology specimens, that's skin pathology specimens, from our Los Angeles operations where we do not have a histopathology lab, to our Aurora anatomical pathology lab in Las Vegas. That's one example. And we believe there will be several more to come.

In terms of our U.S. operations, our growth strategies are gaining momentum. It's likely that despite the slight headwind from the PAMA Medicare fee cuts, we will be presented with additional opportunities because this is probably going to encourage further consolidation of the market. We certainly feel we are large enough and strong enough not only to weather the somewhat choppy conditions, but, in fact, also to benefit from them.

Under the strong leadership of Sonic's U.S. CEO, that's Dr. Jerry Hussong, we are pushing forward with a comprehensive program to enhance Sonic's position in the U.S. lab market, which is the largest medical lab market in the world. This is a program which includes a growth initiative. And that's particularly following the Aurora acquisition, but it also includes an efficiency drive and a push to greater service excellence, and these are all under the guidance of our medical leadership principles.

Finally, just a word about ThyroSeq. This is a relatively new and clinically valuable genetic test, which predicts the malignant potential of thyroid masses or thyroid nodules. Something like 20% to 30% of thyroid nodules are diagnosed as indeterminate after they undergo fine needle aspiration, which is the normal way of initial assessment of a thyroid mass.

The ThyroSeq test then allows classification of these indeterminate cases into those that need immediate surgery and those that can be watched. And the whole purpose of this is to avoid the unnecessary costs and complications of unnecessary surgery. We have licensed this test on an exclusive basis from UPMC, that's the University of Pittsburgh Medical Center, and we offer the test out of our CBLPath lab in New York, which is already an established thyroid cancer center of excellence. The test is fully reimbursed by Medicare and by most of the private payers that we deal with. And we're embarking on a national sales initiative to push this test as strongly as possible into the market, and it certainly does present a very exciting opportunity for Sonic in the U.S.A. We also have and are pursuing an active pipeline of further acquisitions in the U.S. market.

Moving on to Slide 9, which is Australian Pathology. And by way of a general comment about Australian Pathology or an introduction, I should say, we are the #1 player and the market leader in Australia. And our Australian Pathology division is an outstanding Sonic division, which is in a strong and very stable position. And also performing to the highest standards of laboratory medicine. We have outstanding leadership teams and staff throughout Australia who are essentially continually pushing to the edges of best practice, both at operational level and at financial level. And again, under Sonic's medical leadership model.

Revenue for the half came in strong at 7%. At an earnings level, the result was also strong, and we delivered margin accretion to boot. The margin accretion was largely due to the healthy top line growth, but also due to the stabilization of collection center costs and the ongoing scale and synergy benefits, we continue to work on in this division.

At operational level, we are currently building a dedicated Sonic Pathology Australia management team under the leadership of our Australian Pathology CEO, Dr. Ian Clark. And as flagged previously, we've almost completed the national rollout of our total automation system, which is actually the GLP Systems -- Total Lab System, which commenced some years ago, first in Sydney and then in Brisbane and now being rolled out nationally. This rollout brings us absolute cutting-edge operations in our labs. It'll add to our financial efficiencies, and it's also going to improve workflows and are already excellent turnaround times.

In our Australian division, we continue to record strong growth in our genetics sub-division, and we expect this positive trend to continue as demand increases for the existing tests. And as we bring onstream new genetic tests, which keep happening as we go.

Now moving on to Slide 10, which is Germany. And just as an introduction, Germany, as you can see on that pie chart, is one of our 3 largest divisions. Its annual revenues are well in excess of $1 billion. So it's a pretty big division and growing all the time. We are the market leader, the #1 player in the German clinical pathology market. And excitingly now, we've also entered the fragmented anatomical pathology market as well. And so when you put the 2 together, we are very optimistic about our future growth in Germany.

Sonic's medical leadership culture, and I think I've made this point at previous presentations, is deeply embedded in our German division. And it's a division which consistently delivers outstanding services and financial results. And I have to say, the ongoing performance of Sonic Healthcare Germany is a function of not only our staff, but an incredibly dedicated leadership team, headed by our CEO in Germany, Evangelos Kotsopoulos, whom some of you on the call will know.

So looking at the numbers for the half, we achieved 5% revenue growth or 3% organic at constant currency level. That organic growth has been impacted by statutory insurance fee quota changes. But on a positive note, I can say that we are, more recently, sensing that the fluctuations around the EBM fee quotas as they are known, are slowly subsiding. And just a reminder to all that EBM fees represent about 40% of our total Sonic Germany revenues.

What we're observing this financial year is that our organic volume growth is slowly strengthening as we proceed through the year, and we certainly expect that to continue in the remaining 5 months of the year.

In terms of our operations, there continue to be a wide range of activities underway, all aimed at extracting synergies. These include a few laboratory mergers. A comment about our Trier acquisition, which was some 18 months ago. This is an anatomic -- our first anatomical pathology acquisition. This business is performing strongly and we expect that performance to continue. We're working and succeeding at synergy capture between anatomical pathology and clinical pathology. And these can be divided into revenue and cost synergies, as I've mentioned in the U.S. market.

We're achieving revenue synergies via new hospital contracts also via new molecular pathology testing. And also, interestingly, by international referrals of histopathology specimens into our anatomical pathology labs. We do service countries like the Middle East in the clinical pathology space. And so we've now been able to add significant volumes of anatomical pathology specimens, which we can now refer to our own labs.

And in terms of cost synergies, we're finding these in areas of molecular testing and logistics and administration, similar to the situation in the U.S.A. We also have an active pipeline of potential further acquisitions that we're looking at, and these are both in the clinical pathology and anatomical pathology spaces.

And in terms of the regulatory environment in Germany, we continue to work through these ongoing fluctuations in the EBM quota levels, but they are manageable. And I guess we can say that the environment is essentially stable.

Moving on to the next slide, which is the U.K. and Ireland, our revenue growth for the half was 16% or 13% at organic and constant currency level. We continue to enjoy strong growth in both private and the National Health Service market segments.

We're certainly very proud to have won the contract to provide cervical cytology screening, which includes HPV testing for the Greater London region. And I should say that exceptional work was done by our U.K. team, assisted by senior Australian cytology specialists with prior experience in this space here in Australia to launch this program successfully and to deliver it on time. So that cervical cytology contract commenced in the December just past. It's a GBP 15 million per annum contract and a 7-year term on it.

We were also successful in the half in renewing for 10 years the London North West NHS Trust contract, that's an existing contract, but we were pleased to renew that one for a 10-year period. We were not successful in our bid for the large, but I have to say, highly complicated, South East London NHS contract. In this particular situation, our bid was very competitively priced. And I should say that if we were under bid on this deal, as we do suspect, then this would be a deal that we would probably not be comfortable to proceed with at that sort of pricing. We are bidding on further NHS contract opportunities, and these have significant revenue potential as well.

There's also a bit of late-breaking good news in that Sonic's TDL business has been selected to provide laboratory services to the Cleveland Clinic London, which is a flagship new private hospital in Central London, slated to open sometime next year. This is a GBP 1 billion investment by the Cleveland Clinic from the U.S.A. and it seems sure to become a masthead for the brand outside of the U.S.

We are going to open an in-house lab at the same time that the hospital opens next year. But we are going to begin providing outpatient services to this hospital sometime later this year. So the hospital plans to commence outpatient clinical work much sooner than the inpatient beds will open sometime next year.

Now obviously, this is a great honor for Sonic, not only to have been selected, but for us to become now closely associated with the Cleveland Clinic brand, which is certainly one of the most respected medical brands in the world. Our NHS -- our non-NHS business, such as our private business, also remains very strong in the U.K. So this is made up of private hospital pathology, private referrals from the Harley Street market, direct-to-consumer testing, and other non NHS work as well.

We've also, in the period, established a couple of new laboratories to facilitate centralization of our service and this includes the creation of the U.K.'s largest anatomical pathology laboratory. This new anatomical pathology laboratory is located at 60 Whitfield Street, which is the address of our previous central laboratory in London before we relocated to the Halo lab on Houston Road. So we're now processing all the histopathology from UCLH and from the Royal Free Hospitals, which, as you know, are large tertiary teaching hospitals. And we're also processing privately referred specimens coming from private hospitals and the Harley Street market as well.

So you can tell from this particular slide how busy we are and how active we are in the U.K. pathology market. It's certainly a dynamic, if not, sometimes complicated market, but a market that's offering us great opportunities for the future. We're certainly very lucky to have an outstanding leadership team in London. So ably led by Sonic's U.K. CEO, David Byrne.

Moving on to Slide 12, which is Switzerland. We are the market leader in Switzerland as well. We operate in Switzerland under 2 brands: the Medica brand, which is the dominant player in Zurich; and Medisupport, which is headquartered in Geneva on the other side of Switzerland, which has extensive operations throughout the French and German-speaking regions of Switzerland. Both of our Sonic practices continue to operate at exemplary levels. Again, both at operational and financial levels together.

The revenue was strong at 13%, actual currency, 6% constant currency organic. At operational level, we've added a few hospital contracts following the major Zug Cantonal Hospital contract that we won, which we announced previously. We're -- we've completed an upgrade of our Zurich laboratory and efficiency programs have resulted from that upgrade. And the regulatory environment in Switzerland remains stable.

Belgium, and just an introductory few words, this is a strong and stable business, which continues to perform with distinction. Our main laboratory, as you know, is located in Antwerp, but we also run several other laboratories scattered throughout the northern part of Belgium or the Flanders part of Belgium.

All these labs are working together cooperatively to achieve synergies. The revenue growth for the half was 4%, 2% organic growth at constant currency level. And at operational level in keeping with our aim to drive synergies, we've completed the standardization of a Sonic National IT system or LIS system, laboratory information system. We're also expanding our menu of complex testing, and this include genetic tests and we're also working to enhance efficiencies at operational levels wherever we can. And in this half, this included 2 small mergers. The regulatory environment in Belgium also remains stable.

Moving on to Slide 14, which is a slide on Sonic Imaging. The Imaging division produced another strong result, with 8% revenue growth and 10% earnings growth, including a 40 basis point increment in margin, which is a great outcome. On the operations side, I'm pleased to announce that our Queensland X-Ray practice commenced providing imaging services at the Mater Public Hospital Brisbane, and this commenced in November 2019 under a long-term agreement.

Like some of the other deals that we've won or contracts that we've won, this is a great honor for Sonic Imaging, and it really is a tribute to the outstanding stature of our Queensland X-Ray practice. I should say that the strong result in our Imaging division does sheet to our excellent team of Sonic radiologists and imaging staff as well as to our very, very capable leadership teams in all 4 of our practices. It's also in part due to continuing investments that we're making in greenfield sites and in new equipment, and it's good to see the benefits flowing through from those capital investments.

At a regulatory level, the environment is stable. We are going to gain, though, a small benefit from the implementation, a partial fee indexation, which is due to commence July of this year. And also from the introduction of a new MRI and PET CT fee for breast cancer, which has already commenced last November.

And finally, just while on the imaging slide, I'm also pleased to announce that Dr. Julian Adler is to take on the role of CEO Sonic Imaging, and that'll be from the end of this month. But for those of you who don't know Julian, he's a radiologist who joined Sonic 12 years ago. And he has been the CEO of Sonic's Castlereagh Imaging and Illawarra Radiology Group for most of his time with Sonic. And I want to take this opportunity to welcome Julian to Sonic's corporate leadership team.

Slide 15 on Sonic Clinical Services. Again, just to revise, SCS includes all our medical centers under a sub-division, IPN, and a large occupational health division under the brand Sonic HealthPlus. We are the largest primary care provider in Australia and the largest occupational health provider as well. We're operating 229 medical centers at the moment. And we have 2,450 GPs working in our centers, both IPN and Sonic HealthPlus.

Revenue growth for the half came in at 3%. And our sense is that the slightly difficult market conditions in terms of volumes or consultation levels is beginning to improve. Our operations are strong and active. And certainly benefit from an outstanding and very experienced corporate leadership team, headed by our SCS CEO, Dr. Ged Foley, who is an experienced ex-GP himself.

Our doctor recruitment and retention remains strong, and we're actively also engaged in the streamlining of our operations and rationalization of our low-performing centers, and we do this to enhance our efficiencies. And I guess, this will be one of those continuous improvement programs, of which we have many around Sonic Healthcare. The regulatory environment is stable in the private care market.

Moving on to Slide 16. The table on this slide shows only little change in our debt metrics over the prior period. But in summary, our balance sheet is very strong. It's at investment-grade level. And we have around $1 billion of headroom to fund our future growth, which is a nice position for us to be in.

And just a final slide, looking ahead, just a few points. And I guess on that first bullet point, I wanted to say that Sonic is in a strong and stable position. We've -- and it's very much enriched by our deeply embedded culture of medical leadership. As I've said before, it's this culture which continues to drive our brands, which are highly respected and our very high-quality services as well.

So I guess, overall, I feel I can say that Sonic Healthcare is in very good health at this point in time. But having said that, I want to reassure people that we are never complacent. There's no evidence of complacency anywhere around Sonic. And in fact, when I look around the company, I am constantly impressed by the energy, the flexibility or agility of our leaders and staff. And how can I put it? There's a sheer will to win attitude right across our global operations. And it's a good thing to know that Sonic is a company in which culture does run deep. And personally, as just one of our 37,000 employees in Sonic, I can say that it feels pretty good to be part of the spirit that is so strong within the company.

Moving on, and as we look ahead, we are also fortunate in Healthcare to enjoy favorable industry dynamics, which doesn't apply to all industries around the traps. Our industry provides fairly stable, ongoing, noncyclical organic growth. And this is driven by population, aging, new tests, preventative medicine, et cetera.

Looking into the future, our organic growth will obviously be assisted by these favorable industry dynamics, but of course, we also expect major enhancements to that growth to come from new acquisitions, joint ventures and contracts. In other words, the nonorganic growth -- growth of the nonorganic kind.

Our geographical diversification is another thing that we value enormously because it continues to provide benefits going forward. And that's both in terms of new growth opportunities in various markets, but also very much in terms of risk mitigation. We talk about the risk mitigation. If we were experiencing a bit of headwind in the U.S. at the moment with PAMA fee cuts, other divisions are performing strongly, and that leads to a smoothing out of our portfolio. And this has occurred going back many, many years. So there is a huge benefit in being in the 8 good markets that we currently operate in.

Our balance sheet remains pretty strong, as I mentioned, with investment-grade credit metrics, providing us flexibility for growth. And I guess, I do want to acknowledge this as -- and the whole Sonic finance team, which is obviously headed up by Chris and Paul sitting with me today, but also to make special mention of our treasury management team who've done an outstanding job over many years in managing Sonic's balance sheet as well as they have.

The last 2 bullet points on this slide are there to emphasize the ultimate importance of culture, which, as you know, I talk a lot about. Maybe too much about, although I say never too much about, but it's there to emphasize the importance of our -- not only culture, but leadership and our people as well in Sonic's future. And I guess, I have covered off on those sufficiently in this presentation.

So at this point, thank you very much for listening to the presentation. I'm now going to hand you back to our operator, Darren. And ask Chris, Paul and Stephen to join me to take your questions.

Thank you, and thank you, Darren.

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## QUESTIONS AND ANSWERS

**Operator**

The first question is from Lyanne Harrison from Bank of America, Sydney.

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**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

First of all, can we touch on a little bit on the Australian market. Obviously, some very good organic growth there.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Sure. What's the question?

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**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

(technical difficulty)

share, and the contributors to that growth, whether it's mix? And what impact of this flu season had?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

You actually cut out in the middle of that question. But I'd take -- I'd tell you...

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**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

Can you hear me now?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Yes.

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**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

Okay. Do you need me to repeat the question?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Yes, please.

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**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

Okay. If we could touch on the Australian lab market. So obviously, very good organic growth there of 7% this half. Can you share your thoughts on whether or not you've taken market share? And also with the growth, to what extent mix has contributed to it as well as the Australian flu season?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

So when you look at that growth, it's always difficult for us to determine whether we're beating market or not. We tend to use the Medicare stats as the guide. And if you look at the Medicare stats, yes, we're beating market, which would indicate that we're taking market share. However, we have to wait and see what our competitors put out because maybe everyone is going to be above market and then we won't know who's taking market share, and that has happened before.

But just to get serious about your question. All our divisions are performing very strongly in their respective markets. So we cover the whole of Australia. And there's a huge amount of competitive force which is now devolving back to competition on service and quality, given that the collection center issue has stabilized.

So in the past, before this collection center situation arose -- or the collection center rent situation arose, competition was purely in the GP space, purely on service and quality. And then there was this kind of spurious interference from placing collection centers in medical centers which secured you the work. So we are confident that our labs in all states of Australia are in very strong position. So when you look around the traps, even though we don't announce individual company numbers, we can see that we definitely are taking market share in certain states of Australia. So I would say that when you add those to the portfolio, I feel we are definitely taking market share. So that's in the GP space but also the specialist space. Then you've got the hospital -- private hospital market as well, where we also perform very strongly.

So overall, my answer to your question is, yes, I believe we are taking market share.

Bear in mind that the whole market will have grown with the flu season, and it would be in the Medicare numbers, and everyone will enjoy some benefit from that. We obviously did experience an uptick during the peak of the flu season, but -- and that would have helped our growth a little because the previous year was a fairly quiet season in terms of flu testing. So -- and it remains to be seen what's going to happen going forward because what we are finding is even though it's the Australian summer, with not very many people ill, in the northern hemisphere, it appears that people are being -- presenting for testing with respiratory symptoms fearing that they may have coronavirus. And the vast majority don't have it, but they have normal influenza or common cold, rhinovirus results. And so there could be an uptick in the wake of the coronavirus outbreak, but we haven't really seen any effect, certainly not in the first half, related to that.

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**Lyanne Harrison** - *BofA Merrill Lynch, Research Division - VP*

Okay. And whilst on -- just a follow-up question since you mentioned the U.S. In prior calls, you've mentioned or you've called out the work you're doing with joint ventures and partnerships in the U.S. Can you provide some color as to how that's tracked in the first half and what the plans are for the second half?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

I'm going to share the calls around so that other people talk. Paul, do you want to take it? Or Chris?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

I'm happy to speak to it. So look, we haven't obviously announced any new joint ventures in this particular half. That doesn't mean we aren't working on a number of opportunities. The existing joint ventures are performing pretty well, obviously, some better than others. But all as a whole, going quite well. And so we do expect there to be more joint ventures into the future, but the timing on those is always uncertain -- long lead times often as we build relationships with hospital groups. So that's probably all we can say at this moment.

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**Operator**

Next question is from Chris Cooper, Goldman Sachs Sydney.

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**Chris Cooper** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Three for me, too, on the U.S., please, and one just on the U.K. quickly. Let's start with PAMA, please. Just given the changes we've seen there in the legislation, should we be thinking broadly that the fiscal '21 impact is going to be along the same kind of lines as we're seeing in fiscal '20? That's my first question.

Secondly, just kind of bigger-picture one on M&A. I know your comments on the deal pipeline. I'm not really after specifics here, but more of a sort of bigger-picture question in terms of whether the number of opportunities that you're seeing in the U.S. has, I guess, met your expectations over the last sort of 6 to 12 months or so.

And then lastly, just on the U.K. on the Cleveland Clinic contract, could you just give us some sense of size, both in terms of the inpatient and the outpatient piece there? And just confirmation, when you talk about this year and next year, you're referring to calendar year, so when each of those 2 opportunities are going to come on track?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Yes. So just starting with the last question, yes, sorry, I was referring to calendar years. So it -- the hospital is due to open in 2021, calendar. Outpatient services are due to commence in calendar 2020, this year.

We're not able to give you an indication of the scale of the pathology associated with this hospital. It's not going to be enormous, but it's going to be significant. This is not a very big hospital. It's a roughly 200-bed hospital but with a fairly extensive outpatient services as well, which -- whose pathology will all come to us as well.

So we'll update the market in the future on the size of the opportunity, but I guess, we're certainly not able to give you that information right now. We don't know it exactly given that it hasn't yet started.

On the U.S., in terms of the PAMA fee cuts. Yes, in 2021, you can expect a similar impact. And in terms of deal flow in the U.S., I mean, we obviously don't give out information, but other than to say that the M&A market for us is active, very active. So we're looking at opportunities in the 3 major spaces: clinical pathology, anatomical pathology and the hospital market where we tend to look at joint ventures as well. So we're obviously being very prudent as we go forward. What the market never knows is the deals that we don't do. And so there are deals that we do and deals we don't do, and we're just going to progress. But I can just say that this is an active field for us, and there will be deal flow coming through over the coming years.

The third part of your question was the year or...

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

There was a middle question.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

There was a middle one. Chris?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

I think we've covered it.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

We covered it. We've done it all.

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**Chris Cooper** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Yes. No, I think you covered it. I mean, probably just after sort of how you're thinking about the M&A opportunities. I mean, as far as I can tell, you didn't sort of complete any deals regardless of size during the period. And I was just sort of -- going back to sort of previous commentary on that subject and it just suggested to me that perhaps we could or maybe should have expected a bit more to happen in the first half '20. And I just wanted to make sure that this is more just you've been selective rather than sort of a lack of opportunity.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

That's it. You've got it.

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**Operator**

The next question is from Andrew Goodsall from MST Marquee in Sydney.

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**Andrew Goodsall** - *MST Marquee - Healthcare analyst*

Perhaps just a follow-up on the Australian business, just trying to understand if that above-market growth with with the bowel screening and the advertising campaign. Was that was a contributing factor to some of that growth?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

It's a minor factor, Andrew, but I think we've cycled through it already. So it shouldn't really be -- that advertising campaign did increase the volume slightly, giving us a little bit of a lift, but in the scheme of the whole Australian division it's not going to be -- you won't see it. So we were very pleased with that campaign. It gave Sonic free television advertising and radio advertising, which was great.

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**Andrew Goodsall** - *MST Marquee - Healthcare analyst*

In the middle of the Australian Open, which was was good.

And then just perhaps flipping to the U.S., there's been some noise around professional services fee cuts in calendar year '21. Just your sort of thoughts around the status of that and how that might play.

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

Yes, Andrew, it's Chris here. There have been some suggestions of changes, but I don't think that's been confirmed at all at this point in time. Either the quantum or the timing of it, from what I understand, unless anyone all around the table here got a different understanding. In fact, I believe there's still some discussions between the industry and the authorities on just whether or not that's appropriate. So that's still, as I understand it, sort of a work in progress.

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**Operator**

The next question is from Steve Wheen from Evans & Partners, Sydney.

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**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

I was wondering if you might be able to help us strip out the acquisition effect and what the underlying growth, ex acquisitions, would look like in the half. I think you mentioned at the full year '19 result is somewhere around 3%. Are we still on track for that sort of figure?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

So the major acquisition, obviously, is Aurora. And at the time that deal was announced, we gave you the EBITDA and revenue of that business so you can sort of work that through. Nothing's changed in any significant way from what we would have said in August when we gave the guidance. I can't remember exactly what we said at that time, but certainly Aurora is a fairly significant part of the 6% to 8% range.

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**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Yes. Okay. And then could I just ask on the AASB 16 adjustments. Again, back to FY '19 result, you gave some sort of, I guess, tentative guidance around the impact being $300 million at a D&A level -- at D&A and interest level. It looks like it's quite a bit higher. Could you -- is that -- am I reading that correctly? The disclosure you've made is $155 million for the half. And I think about $13 million in interest, which would see the full year effects be closer to $340 million, $350 million?

**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

So the guidance we gave back in August was that the effect on depreciation or EBITDA would be in the order of $0.3 billion, which is your $300 million. Yes, that was an approximate number. We come in, it's -- the comparative to that is the $155 million. So if you double the $155 million, we're pretty close, I would say, to the guidance that we gave back in August.

**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Okay. So yes, okay. I interpreted that it also captured the interest component as well?

**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

No, it did not.

**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

And so is that about $13 million for the half? Is that correct?

**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

We should -- you could see that from Page 2 of the announcement, the 4D announcement. So it's taken interest from 39 to 53. So it's not terribly significant.

**Operator**

We now have Sean Laaman from Morgan Stanley in Sydney.

**Megan J. Kirby-Lewis** - *Morgan Stanley, Research Division - Research Associate*

Colin, it's Megan on the line for Sean. Two questions from me. Firstly, just on the Aurora acquisition and the synergies on the cross-selling there. What have we seen so far since you've acquired the business? And how should we think about that opportunity going forward?

And then my second question is just on Germany. I'm just interested in the growth rates there since you've lapped the fee quota changes.

**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Yes. So in terms of the cross-sell and general synergy activity in the U.S., we are very active in setting up arrangements, plans for the cross-sell. And there's different opportunities in different markets, and it probably won't be appropriate for me to go into detail because a lot of them are competitive in nature. But I gave just the one example of what's happening just in terms of new referrals from an area where we don't do anatomical pathology and referring from a clinical pathology customer that we have -- customers where we previously would allow the anatomical pathology to go to a third-party lab, we're now sending to our lab in Vegas. But there are several other opportunities like this across the U.S., and they're all different.

So this is something that we have to do very carefully. They can't happen in a day or a week or even a month. They've got to be planned very carefully. And it's something that's going to evolve incrementally over the coming years. So we identify this as a major synergy opportunity for Sonic going forward.

Sorry, the second question was?

Hello?

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**Operator**

Okay, the next question is from David Low, JPMorgan in Sydney.

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**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

Maybe I'll ask that question since you missed it. What happened with quotas in Germany?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

So the quotas, as you I think are aware, David, we only find out the final quota number for a quarter about 5 months after the end of that quarter. So there is a degree of estimation or judgment that's applied in each half. Taking it into account that that judgment -- and sorry, the quota levels for the quarters have changed throughout the last few quarters. So sometimes they're up, sometimes they're down. That's the volatility that Colin referred to in the presentation. Overall, though, and taking into account adjustments to our previous estimates, they were a headwind in this half.

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

They vary by not just across the board, but via the different states within Germany. So it is a little hard to model the -- some are up in the same period. Some are up and some are down. So it's a bit of a function, as you know, the way the mechanism works, mainly on the volume and the bucket of budget that the KV holds in that state.

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**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

Yes. So frankly, that is a number that we can't see. We've got no visibility on it from Germany. I don't quite understand why you wouldn't break it out, giving us an organic growth rate, and tell us what the average price impact was. I mean, is it 1% headwind or a 3% headwind?

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

We haven't disclosed that. So it's probably not something that we should disclose on this call. But it's at the lower end of those ranges you gave.

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**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

All right. I mean, I might suggest that perhaps give us a little bit of a hint as to what it is, given we don't get any visibility at all.

Look, my other question, just on guidance. I mean, 11% in the first half, obviously, supported by Aurora. You haven't changed your guidance and you've told us that the underlying organic growth is 5, which would imply pretty much the top end of the guidance. I just want to think -- I would like you to talk to the other variables for us to consider with -- PAMA cuts being the obvious one. Is there anything else that would drag down the second half?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Not really. And so you're looking at it right. You've got 1 month of Aurora in the second half. We're assuming status quo in Germany, status quo in the U.S., ongoing strong performance in Australia and imaging and SCS. So we don't want to jump the gun, but you said what you said. And it's more or less right.

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**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

Okay, perfect. I might squeeze in one more, if I could. SCS is obviously quite hard for us to get much visibility on because it's in the other category. I'm wondering if you could talk to -- I mean, we see the revenue growth, but just if you could talk to what happened with margins in that division, and maybe within that comment on corporate costs, which I believe are the major variable in that other category.

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

Maybe I'll answer that one. So yes, look, you've seen the revenue for SCS. We don't disclose the profitability, but that business is reasonably stable. The other category is also affected, you might remember by -- in the previous year by the GLP one-off profit -- that in the previous corresponding period by the profitability of GLP, which is no longer there because that business has been sold. There's also a little more corporate cost relating to the move of the Sonic head office into the city. And as Colin alluded to in his presentation, the fact that we have sort of beefed up an Australian pathology head office now, which is a dedicated team that previously it had some of the group head office people playing dual role.

So there is a slight increase in corporate cost as a consequence of that as well. So what you can see there is the -- is probably a reasonable idea of the run rate for the half going forward depending on the ongoing performance of SCS.

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**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

Right. So SCS didn't deteriorate materially?

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

No, no, it didn't. And look, there are also some one-off costs related to things like the the bid for South East London, which finds its way as a corporate sort of cost into that category as well.

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**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

Great. Just given you've raised that the nonrecurring item in the accounts there, which is acquisition and restructuring, is the same as it was last period with no acquisitions announced, so Southeast London is part of it, anything else? I mean, did you miss out on other deals that drove that cost up? Or is it restructuring, as I see is the other one?

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

It's probably more in the sort of restructuring category. There's lots of things that are happening around the group in Germany. There's integration of labs, likewise, in the U.S. and other places. So what we try and pull out there are some costs that are related to restructuring, the issues that happen in a particular period that aren't going to repeat the next year.

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

And David, just because an acquisition isn't announced in a period, it doesn't mean...

**David A. Low** - *JP Morgan Chase & Co, Research Division - Research Analyst*

I get that. That's why I'm asking.

**Operator**

The next question is from Gretel Janu from Crdit Suisse, Sydney.

**Gretel Janu** - *Crédit Suisse AG, Research Division - Research Analyst*

So just firstly, on Australia. So back at the results in August, you called out reduction in the number of collection centers. Can you please update us on this, and whether you plan to see further rationalization here?

**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

I'll hand this one to Stephen.

**Stephen Fairy**

Thank you. I think since we last reported collection center numbers, there has probably been a very slight increase in the number of collection centers within Australia, and that's related to growth across that time. At the same time, we have been rationalizing our collection centers, closing underperforming collection centers. So netting out a slight net increase in collection centers, but with an overall stabilization of the total cost of those rentals with some renegotiation of existing leases and some resetting of the market expectations for leases in that space. 111

**Gretel Janu** - *Crédit Suisse AG, Research Division - Research Analyst*

Great. And then just in terms of pathology margins. So you called put out margin accretion in Australia. Can you give us a bit more color on the margin performance for the other regions, as to which regions in particular offsets that Australia margin accretion to get roughly flat margins for pathology?

**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

Yes. Look, it's Chris here. We've don't -- we've got to be careful here about not -- announcing information on this call that's not included in the documents we just released to the exchange. So we can't give you any more detail on that, unfortunately. But I guess it would be fair to say that the main headwind, which we talked a bit about here is the PAMA cuts in the U.S., which is not insignificant, circa AUD 20 million. So that is a bit of a headwind. The rest of the -- which is public, the rest of the businesses have been reasonably positive, reflecting the pretty strong organic revenue growth.

**Operator**

We now have John Deakin-Bell from Citigroup, Sydney.

**John Deakin-Bell** - *Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand*

A couple of quick questions. Just on the CapEx. I know you've guided that to be a lower number going forward. But you seem to have got a lot of refurbishments around the world. Can you just give us a sense of how that might look over the next couple of years?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Paul, would you take that one?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

Chris will.

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

Yes, actually -- I'll answer that one. John, look, we did guide to a lower position for the year, and we still are confident that that's going to be the case. Although there's always things happening in various parts of the world. The first half is actually a bit higher than the previous corresponding period. But if you look at the numbers for the second half of FY '19, it was -- there were some chunky amounts there. So we're expecting the second half of this financial year to be quite a lot less than the previous corresponding period and then bring us down in total for the spend.

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**John Deakin-Bell** - *Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand*

Are we looking -- I mean, I think we've got like $50 million less next year -- this year than last year, et cetera. I mean, are we talking about that order of magnitude? Or can you give us a range, perhaps?

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**Christopher David Wilks** - *Sonic Healthcare Limited - Finance Director, CFO & Executive Director*

It may not be quite as much as that. But again, we've just said less, but call it, say, 10% less than the prior year. Something like that, is what we're expecting.

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**John Deakin-Bell** - *Citigroup Inc, Research Division - Director & Head of Healthcare in Australia and New Zealand*

Okay, that's helpful. And then just maybe just on the Australian business, again, sometimes you call out about the regulatory environment. You said it in some of the other markets. But in the sense of a foggy environment, can you give us -- and there's been a lot happening in the background on rentals and stuff that we don't see. Can you just give us a little color, Colin, perhaps on how you think the regulatory environment is tracking here in pathology?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Yes. So we call it as stable because at reimbursement level, it is stable. So at that level, there's very little activity. There's nothing to report. In terms of the collection center rents, we've spoken so much about this.

I should let you know, John, that the compliance division of the Department of Health is continuing with quite a lot of activity right now to try and bring some control to the rents charged for collection centers. So they continue to send out letters to landlords and lessees. Their selection criteria are unknown to us, but they do include rents that are particularly high, rents that have changed or the leases that have changed. There's a bunch of criteria that they use. And they are working to, I guess, determine whether there are any breaches of the Health Insurance Act. Now remember, they're doing this work in the absence of a clear definition of market rent. So whether or not they're going to use other instruments, which are available to them, which we don't need to go into on this call, remains to be seen.

But I guess, we don't have any input into this. But the compliance division that was set up specifically by the Minister of Health to deal with collection center rents is very active at the moment. So I guess it's a matter of -- we've got to just stay tuned and see what happens.

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**Operator**

We have Saul Hadassin from UBS, Sydney.

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**Saul Hadassin** - *UBS Investment Bank, Research Division - Executive Director & Research Analyst*

Just the first question, just noticed in the cash flow statement, another sort of close to $50 million in cash flow from investments in purchases. Just wondering what does that include.

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

Sorry, the payments for controlled entities, is that the line you're looking at?

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**Saul Hadassin** - *UBS Investment Bank, Research Division - Executive Director & Research Analyst*

Yes, is it U.S. JV? Is it Aussie medical centers? Just what is that comprised of?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

Yes. So there's a mix of things. The biggest piece of that was in relation to our Steinberg anatomical pathology practice in Germany. Previously, we owned 51% of that practice. So we're already consolidating it. We're already booking 100% of the revenue on EBITDA, but there was obviously a minority interest component to it. We acquired the balance of that practice in this period, so that is the biggest piece of that 47. There were some consideration paid, so deferred consideration from acquisitions in prior years that are in that number as well. There were some small acquisitions in the SCS business as well in there. So a number of different components. But the major one is the Steinberg piece.

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**Saul Hadassin** - *UBS Investment Bank, Research Division - Executive Director & Research Analyst*

Thanks, Paul. And just one other for me. One of the large U.S. competitors recently noted in their quarterly call that -- regarding PAMA fees, that some of their older commercial contracts that were being renegotiated there. They had seen some impact, albeit modest, from renegotiated contracts at low rates. Can you just talk to your commercial contracts in the U.S., just in terms of whether you are seeing any pressure at all on the back of the reduced PAMA fees?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

So certainly, no significant change to the level of pressure in the market. From time to time, funders will -- or insurance companies will try to achieve lower pricing. It's a one-on-one negotiation. Depending on our market position, we push back. And there's no sort of change to that dynamic.

Really, it's a circular argument, right, because the whole reason for PAMA is because the government could -- was of the view that private insurers were paying less. So for the private insurers to expect us to accept reductions because the PAMA fees are coming down isn't really a logical proposition. Obviously, we push back and say, well, in effect, PAMA was -- or sorry, Medicare was subsidizing the rates we were already offering you. But as I say, it's a one-on-one negotiation with each fund in each region. And nothing's really changed in that dynamic.

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**Operator**

We have David Bailey from Macquarie Bank, Sydney.

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**David Bailey** - *Macquarie Research - Research Analyst*

Just had some questions in relation to Imaging, actually. Some decent margin accretion coming through there. Just interested in the driver of that. Is that mix to higher fee modalities? Or is there some contract wins coming through, driving that 40 basis points of margin expansion?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

David, it's a mix of a range of factors. There's no one particular reason. As we've flagged that we have made some investments in new gear and in greenfield sites. We've got stable businesses with fairly good top line growth, which really obviously helps at the margin level. There's no particular contract. There's a new one that we've just mentioned, which is in Brisbane, at the Mater Hospital but you won't see much of that. That's not seen in the H1 result all that much.

So I mean, it's a situation where we're competing for market share with a stable group of radiologists and leaders and staff. And we've had a slight bump up in some of the fees, but -- so you can see that there's a whole bunch of factors, which are contributing to a stable and good operation with decent top line growth and delivering some margin accretion, which we hope to continue.

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**David Bailey** - *Macquarie Research - Research Analyst*

Got it. And then just relating to the growth strategy for that business, will it be confined to greenfields and brownfields? Or would you consider acquisition opportunities should they arise as well?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Yes. I mean, we debate that question. And we're obviously -- at the moment, we've been with our 4 divisions for a long time now. We have -- we've got a joint venture-type arrangement in Melbourne at the Airport Hospital. And we're sort of open to M&A at reasonable levels. So if it suits our business and if the price is right, then we are happy to have a look at growth via that route. We're not, at the moment, thinking of expanding Imaging outside of Australia, though.

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**David Bailey** - *Macquarie Research - Research Analyst*

Got it. And just a final one, just in relation to the MBS indexation impact you mentioned. Just wondering if you've managed to quantify any aspects of that, be it top line growth or top line dollars or impacts for the group.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

You mean in the general practice?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

Radiology.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Radiology?

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**David Bailey** - *Macquarie Research - Research Analyst*

Radiology, yes.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Okay. Paul, do you -- I think...

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

Look, we don't have accurate numbers on the number to hand, and the reality is they're not particularly material in the scheme of even Sonic Imaging, let alone Sonic. So I probably can't give you an exact number there.

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**David Bailey** - *Macquarie Research - Research Analyst*

That's all right. That's fine. I thought I'd try anyway.

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**Operator**

Next question is from Steve Wheen, Evans & Partners, Sydney.

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**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Yes. Sorry, I just wanted to clarify something, just with regards to PAMA. Earlier in January, there was some talk about the PAMA cuts to '21, the cap increasing to 15%. Is that being formalized, and therefore, does that put risk on the dollar impact that you quoted increasing in '21?

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

So the 15% is correct. That's the maximum that a test can go down from 1 January '21. That's true. What we don't have precise numbers for is exactly how that will play out because it only goes to 15% for a particular test if the market data show that that level of reduction was required. So you shouldn't think of it as a 15% cut across the board. That won't be the case. It's more -- there's more to it than that in terms of the calculation. I guess, what Colin was indicating is that the effect won't be substantially different to what it has been in this year.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

And also, so just to be clear, our Medicare revenue is 12% of our total revenue. And there are moves now, looking ahead through the so-called LAB Act, to revise and redo the surveying to determine the market rents of all these tests.

So as everyone knows, the way the market rates of these tests was determined was incorrect because it only included a very small proportion of the labs and didn't include the hospital labs, for example. And so we're hoping that through this now legislated instrument, the LAB Act, the process to determine these market rates will be done correctly.

Now it is our view and a pervasive view in the U.S. market, that if the survey is done correctly, the market rates will all be a whole lot higher than they are right now. So it's going to be an interesting thing to see what happens as we go into 2021 and 2022.

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**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Yes. Clear. And just quickly, any interest in the Healthscope, New Zealand pathology assets?

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

So Steve, we can't talk about this kind of stuff. We haven't put out anything formal about anything, just to say that we look at opportunities as they come our way. We don't tell the -- we don't flag the market what we're looking at, what we're not looking at. We're not allowed to. You'll understand that?

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**Steven David Wheen** - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Yes.

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**Operator**

There are no more questions.

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**Colin Stephen Goldschmidt** - *Sonic Healthcare Limited - CEO, MD & Executive Director*

Good.

Well, thank you, then, everyone.

Thanks, Darren.

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**Paul J. Alexander** - *Sonic Healthcare Limited - Deputy CFO & Company Secretary*

Thank you.

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**Operator**

You're welcome.

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