Highlights of the Discovery Health Medical Scheme's financial results for 2012

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This document contains highlights of the Scheme's results for the year ended 2012, extracted from the 2012 Integrated Annual Report. The financial information has been extracted from and is in agreement with the Annual Financial Statements audited by PricewaterhouseCoopers Inc.

The 2012 Integrated Annual Report including the full set of Audited Annual Financial Statements and the Report by the Board of Trustees will be available on www.discovery.co.za from 19 April 2013 as well as at the following customer service centres from 2 May 2013:

Johannesburg

Discovery Health

16 Fredman Drive

Sandton

Pretoria

Discovery Health

Corner of Oak and Tegel Avenues

Highveld Techno Park

Centurion

Cape Town

Discovery Health

Knowledge Park

Heron Crescent

Century City

Durban

Discovery Health

41 Imvubupark Place

Riverhorse Valley Business Estate

Durban

Port Elizabeth

Discovery Health

BPO Building

Coega IDZ

Zone 4

Principal Officer's report

The 2012 financial year was another challenging one for all medical schemes. Ongoing economic uncertainty, rising healthcare costs due to utilisation changes and increased disease burden, and intense media and public debate around healthcare issues continued to impact the healthcare industry. In the face of these complexities, the Discovery Health Medical Scheme continued to deliver on its core purpose of funding quality, cost-effective healthcare cover for all its members, and achieved a positive operating result for the period under review. The Scheme's gross contribution income was R35.19 billion, with a net surplus (including investment income) of R789 million.

The Scheme again experienced substantial membership growth, increasing principal membership by 6% off an already high base. Overall, the Scheme added 64 224 new principal members, and ended the year with 2 469 023 million lives covered. The Scheme now covers 51% of the lives in the open medical scheme industry and 30% of the total medical scheme industry, enhancing its position as the benchmark open medical scheme in South Africa. In a community-rated regulatory environment, continuous and steady membership growth is vital for the sustainability of medical schemes.

When considering the drivers of medical inflation over the past five years, non-healthcare expenditure has been the Scheme's only cost component that has been reducing consistently in real terms. The Board of Trustees has set a combined administration and managed healthcare fees target of 10% of total annual contribution income, to be achieved by 2014. While claims have increased by 17.5% over and above consumer price inflation over the past five years, administration and managed healthcare fees have had a deflationary effect of 4.6% over the same period.

The Discovery Health Medical Scheme's substantial membership growth continues to create solvency pressures on the Scheme, which is required to maintain accumulated funds of 25% of annual contribution income. The Scheme's solvency ratio is now at 23.41%, in line with the solvency trajectory agreed with the Council for Medical Schemes. The Council has approved the Scheme's business plan detailing the timeline over which the Scheme will increase solvency to 25%. It is estimated that this solvency level will be reached by 2015. In increasing solvency, annual contribution increases and building the Scheme's reserves must be carefully and responsibly balanced without increasing the financial burden on members. The value of Scheme reserves has increased to R8.2 billion, which is indicative of the significant financial strength and scale of the Discovery Health Medical Scheme in the private healthcare industry.

During the 2012 financial year, the Discovery Health Medical Scheme continued its commitment to providing rich benefits and the widest plan choices to all Scheme members, while at the same time expanding access to more affordable healthcare cover to a broader base of the lower income market. The Scheme's contribution increases for 2013 ranged between 9.8% and 11.8%, and were set to recognise the difference in demand-side effects between different plans, ensure sustainability of cover for low-income members, and continue to build solvency while growing membership. The Discovery Health Medical Scheme remains the most affordable medical scheme choice across the entire spectrum of healthcare needs.

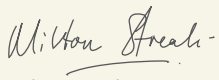
The confidence in the Discovery Health Medical Scheme and its ability to retain members is demonstrated by the extremely low number of members leaving the Scheme (the lapse rate). During 2012, the lapse rate reduced even further to 4.1% (2011: 4.3%), and remains the lowest in the open medical schemes market by a significant margin. The position of the Scheme in the private healthcare industry has again been validated by the AA+ credit rating of the Scheme by independent credit rating agency Global Credit Ratings – the highest rating an open medical scheme in South Africa can receive. The Scheme has sustained this rating for 12 consecutive years.

Over the past 20 years, the unique and successful health risk management operating model employed by Discovery Health (Pty) Ltd has continued to ensure the cost-effective management of healthcare funding and the sustainability of the Discovery Health Medical Scheme. The efficiency of this integrated model, which is built on innovation, collaboration, good corporate governance, transparency and member engagement, has been demonstrated by the success of the Scheme relative to all its competitors, on every performance metric. The scale of the operations of Discovery Health (Pty) Ltd is unparalleled in the industry, with over 35 300 calls answered each day and claims volumes of 3.9 million a month. Independent industry surveys have confirmed that the services provided by Discovery Health (Pty) Ltd are among the most highly rated in the industry. In 2012, the Administrator and Managed Healthcare Provider achieved an all-time high client satisfaction score of 8.96 (out of 10).

The Scheme and Discovery Health (Pty) Ltd have leveraged the Scheme's scale to develop a range of technological and service innovations aimed at ensuring quality of care for members, greater control of costs, and the improvement of members' experience in the healthcare system. These revolutionary innovations include smartphone and iPad applications for both healthcare professionals and members, telemetry and other devices, and iPad applications for healthcare advisers. HealthID was launched in 2012 – it is a groundbreaking iPad application for healthcare professionals and a first in the private healthcare industry in South Africa. It provides a platform for sharing clinical information to facilitate better coordination of care, improve efficiency and patient outcomes and streamline doctors' administration.

Discovery Health (Pty) Ltd has invested significantly in a wide range of benefit and risk management assets and tools. These include a number of important healthcare provider assets within the healthcare system. These capabilities and assets have succeeded in "bending the cost curve" for the Discovery Health Medical Scheme and lowering the cost of healthcare for both Scheme members and the industry.

The Discovery Health Medical Scheme will focus on ensuring continuous best practice governance, a continued focus on innovation in risk management and alternative reimbursement strategies, and enhanced stakeholder engagement and relationship strategies. Innovation in product design to maintain and enhance the Scheme's competitive and product leadership positions also remains a key strategic imperative. Through its commitment to best practice governance, the Discovery Health Medical Scheme Board of Trustees and the Administrator and Managed Healthcare Provider, Discovery Health (Pty) Ltd, will continue to navigate the complex private healthcare system optimally to ensure continuous excellent value for members.



Milton Streak
Principal Officer

Key financial and service metrics

Key financial and service metrics	2012	2011
Members' funds	R8.2 billion	R7.4 billion
Solvency ratio	23.41%	23.50%
Membership (lives)	2.47 million	2.35 million
Gross contribution income	R35.19 billion	R31.19 billion
Risk contribution income	R28.23 billion	R24.97 billion
Average risk contributions per beneficiary per month	R974	R904
Average risk claims per beneficiary per month	R801	R747
Reserves per beneficiary at year-end	R3 338	R3 151
Average return on investments as a percentage of investments	5.83%	6.31%
Number of hospital admissions	588 936	547 705
Average age at year-end	32.95	32.78
Pensioner ratio at year-end	7.36%	7.05%

Extracts from the Audited Annual Financial Statements

	2012 R'000	2011 R'000
STATEMENT OF FINANCIAL POSITION		
at 31 December 2012		
ASSETS		
Current assets	12 108 480	10 580 460
Financial assets at fair value through profit or loss	6 968 790	8 012 078
Derivative financial instruments	-	23 424
Trade and other receivables	1 459 601	1 318 307
Cash and cash equivalents		
Personal Medical Savings Account trust assets	2 260 141	-
Medical Scheme assets	1 419 948	1 226 651
Total assets	**12 108 480**	**10 580 460**
FUNDS AND LIABILITIES		
Members' funds	8 240 820	7 419 231
Accumulated funds	8 240 820	7 419 231
Current liabilities	3 867 660	3 161 229
Outstanding claims provision	768 675	567 845
Derivative financial instruments	32 673	2 218
Personal Medical Savings Account trust liabilities	2 291 580	1 930 591
Trade and other payables	774 732	660 564
Members' trust funds	-	11
Total funds and liabilities	**12 108 480**	**10 580 460**
STATEMENT OF COMPREHENSIVE INCOME		
for the year ended 31 December 2012		
Risk contribution income	**28 225 777**	**24 972 943**
Relevant healthcare expenditure	**(23 093 400)**	**(20 509 303)**
Net claims incurred	(23 194 642)	(20 651 339)
Claims incurred	(23 332 148)	(20 777 150)
Third party claim recoveries	137 506	125 811
Net income on risk transfer arrangements	101 242	142 036
Risk transfer arrangement fees	(263 898)	(229 132)
Recoveries from risk transfer arrangements	365 140	371 168
Gross healthcare result	**5 132 377**	**4 463 640**
Managed care: management services	(991 216)	(882 883)
Broker service fees	(755 803)	(688 812)
Expenses for administration	(3 084 814)	(2 863 572)
Other operating expenses	(113 365)	(105 973)
Net healthcare result	**187 179**	**(77 600)**
Other income	**719 388**	**679 474**
Investment income	617 289	565 296
Net fair value gains on financial assets at fair value through profit or loss	96 067	109 248
Sundry income	6 032	4 930
Other expenditure	**(117 777)**	**(31 464)**
Expenses for asset management services rendered	(13 701)	(11 956)
Interest on Personal Medical Savings Accounts	(104 076)	(19 508)
Net surplus for the year	**788 790**	**570 410**
Other comprehensive income	-	-
Total comprehensive income for the year	**788 790**	**570 410**

Extracts from the Audited Annual Financial Statements

	2012 R'000	2011 R'000
STATEMENT OF CHANGES IN FUNDS AND RESERVES		
for the year ended 31 December 2012		
Balance at beginning of the year	7 419 231	6 847 076
Total comprehensive income for the year	788 790	570 410
Reserves transferred from other medical schemes	32 799	1 745
Balance at the end of the year	**8 240 820**	**7 419 231**
STATEMENT OF CASH FLOWS		
for the year ended 31 December 2012		
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash flows from operations before working capital changes	224 977	(47 125)
Working capital changes:		
Increase in trade and other receivables	(186 861)	(220 563)
Increase in outstanding claims provision	200 830	7 248
Increase in Personal Medical Savings Accounts	360 989	212 149
Increase/(decrease) in trade and other payables	114 169	(4 878)
Cash generated/(utilised) by operations	714 104	(53 169)
Purchases of financial instruments	(1 938 983)	(2 032 830)
Proceeds from sale of financial instruments	3 132 216	1 492 527
Interest received	600 265	554 426
Dividend income	17 124	10 896
Interest on Personal Medical Savings Accounts	(104 076)	(19 508)
Net cash flows from operating activities	**2 420 650**	**(47 658)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments out of members' trust funds	(11)	(339)
Reserves transferred from other medical schemes	32 799	1 745
Net cash flows from financing activities	**32 788**	**1 406**
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	2 453 438	(46 252)
Cash and cash equivalents at the beginning of the year	1 226 651	1 272 903
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	**3 680 089**	**1 226 651**
Cash and cash equivalents comprise of:		
Personal Medical Savings Accounts trust assets	2 260 141	-
Medical Scheme assets	1 419 948	1 226 651
Balance at the end of the year	**3 680 089**	**1 226 651**
CASH FLOWS FROM OPERATIONS BEFORE WORKING CAPITAL CHANGES		
Net surplus for the year	788 790	570 410
Adjustments for:		
Impairment losses	45 567	37 527
Interest received	(600 265)	(554 426)
Dividend income	(17 124)	(10 896)
Interest on Personal Medical Savings Accounts	104 076	19 508
Net losses on financial assets at fair value through profit or loss	(96 067)	(109 248)
	224 977	**(47 125)**
FINANCIAL ASSETS HELD AT FAIR VALUE THROUGH PROFIT OR LOSS		
Held for trading:		
Current assets	6 968 790	8 012 078
Offshore bond portfolio	422 942	528 352
Listed equities	472 567	377 102
Yield-enhanced bond portfolios	850 412	741 992
Money market portfolios	5 222 869	6 364 632
	6 968 790	**8 012 078**

Extracts from the Audited Annual Financial Statements

	2012 R'000	2011 R'000
PERSONAL MEDICAL SAVINGS ACCOUNT TRUST LIABILITIES		
(Personal Medical Savings Account trust monies managed by the Scheme on behalf of its members)		
Balance on Personal Medical Savings Accounts at the beginning of the year	1 930 591	1 718 442
Add:		
Personal Medical Savings Account contributions received or receivable	6 969 850	6 219 912
For the current year	6 969 850	6 219 912
Interest on Personal Medical Savings Accounts	104 076	19 507
Transfers received from other medical schemes	17 211	11 659
Less:		
Claims paid to or on behalf of members	(6 581 347)	(5 911 391)
Refunds on death or resignation	(148 801)	(127 538)
Balance due to members on personal medical savings held in trust at the end of the year	**2 291 580**	**1 930 591**

It is estimated that claims to be paid out of members' Personal Medical Savings Accounts in respect of claims incurred in 2012 but not recorded will amount to approximately R43 652 635 (2011: R21 898 422).

As at 31 December 2012 the carrying amount of members' Personal Medical Savings Accounts was deemed to be equal to their fair values, which is the amount payable on demand. The amounts were not discounted, due to the demand feature.

Interest is allocated on these Personal Medical Savings Account balances in accordance with Circular 38 of 2011 and Circular 5 of 2012 issued by the Council for Medical Schemes. The Scheme does not charge interest on negative Personal Medical Savings Account balances.

PERSONAL MEDICAL SAVINGS ACCOUNT TRUST ASSETS		
(Monies managed by the Scheme on behalf of members)		
CASH AND CASH EQUIVALENTS		
MOMENTUM PERSONAL MEDICAL SAVINGS ACCOUNT TRUST PORTFOLIO		
Balance at the beginning of the year	-	-
Additional investments	1 128 127	-
Interest income	1 880	-
Fair value adjustments	(25)	-
Balance at the end of the year	**1 129 982**	-
TAQUANTA PERSONAL MEDICAL SAVINGS ACCOUNT TRUST PORTFOLIO		
Balance at the beginning of the year	-	-
Additional investments	1 128 577	-
Interest income	1 582	-
Fair value adjustments	-	-
Balance at the end of the year	**1 130 159**	-
Total Personal Medical Savings Account trust assets	**2 260 141**	-

These funds represent members' Personal Medical Savings Account assets managed by the Scheme on behalf of its members. As required by Circular 38 of 2011 and Circular 5 of 2012 issued by the Council for Medical Schemes, these assets have been invested separately with effect from the 2012 financial year.
The difference between total Personal Medical Savings Account trust assets and Personal Medical Savings Account trust liabilities arises from timing of cash flows to or from the portfolios.

STATUTORY SCHEME SOLVENCY		
Total members' funds per Statement of Financial Position	8 240 820	7 419 231
Less: cumulative unrealised net gain on remeasurement to fair value of investments	-	(90 436)
Accumulated funds per Regulation 29	8 240 820	7 328 795
Gross contributions	35 195 627	31 192 855
Solvency margin		
= Accumulated funds / gross contribution income x 100%	23.41%	23.50%

Operational statistics

2012	Executive	Classic Comp	Classic Core	Classic Saver	Classic Priority	Essential Comp	Essential Core	Essential Saver
Number of members at the end of the accounting period	11 964	184 153	50 892	203 537	100 772	27 873	25 770	70 606
Number of beneficiaries at the end of the accounting period	27 644	438 966	110 043	441 050	232 561	59 076	54 981	154 137
Average number of members for the accounting period	12 092	186 101	49 578	197 034	100 132	28 184	24 055	67 869
Average number of beneficiaries for the accounting period	28 003	444 176	107 538	428 802	230 195	59 704	51 573	148 564
Average risk contributions per beneficiary per month (R')	1 961	1 531	982	926	1 071	1 522	797	804
Average relevant healthcare expenditure per beneficiary per month (R')	2 568	1 483	641	643	815	1 155	181	1 392
Average non-healthcare expenditure per beneficiary per month (R')	177	172	181	184	177	194	62	518
Average administration costs per beneficiary per month (R')	110	107	118	117	111	121	119	117
Average managed care: management services per beneficiary per month (R')	32	31	34	34	32	35	35	34
Beneficiaries per member at 31 December	2.32	2.39	2.17	2.18	2.30	2.12	2.14	2.19
Dependants per member at 31 December	1.32	1.39	1.17	1.18	1.30	1.12	1.14	1.19
Relevant healthcare expenditure as a percentage of risk contributions (%)	131	97	65	69	76	76	65	60
Non-healthcare expenditure as a percentage of risk contributions (%)	9	11	18	20	16	13	23	22
Net healthcare result for the year	(263 625)	(658 860)	205 852	509 833	217 806	124 149	60 067	250 885
Net surplus/(deficit) for the year	(257 041)	(557 543)	232 689	616 447	272 173	139 494	72 999	287 533

2012	Essential Priority	Coastal Saver	Coastal Core	KeyCare Plus	KeyCare Core	Discontinued plan	Total
Number of members at the end of the accounting period	9 704	156 447	75 018	209 230	15 124	N/A	**1 140 090**
Number of beneficiaries at the end of the accounting period	20 442	361 272	166 807	378 054	23 990	N/A	**2 469 023**
Average number of members for the accounting period	9 403	153 237	72 313	197 123	14 316	N/A	**1 111 438**
Average number of beneficiaries for the accounting period	19 756	354 608	161 112	357 700	22 735	N/A	**2 414 467**
Average risk contributions per beneficiary per month (R')	1 053	723	720	587	583	N/A	**974**
Average relevant healthcare expenditure per beneficiary per month (R')	647	554	545	532	311	N/A	**797**
Average non-healthcare expenditure per beneficiary per month (R')	190	172	173	136	113	N/A	**171**
Average administration costs per beneficiary per month (R')	122	110	115	73	44	N/A	**106**
Average managed care: management services per beneficiary per month (R')	35	32	33	41	47	N/A	**34**
Beneficiaries per member at 31 December	2.10	2.31	2.23	1.81	1.59	N/A	**2.17**
Dependants per member at 31 December	1.10	1.31	1.23	0.81	0.59	N/A	**1.17**
Relevant healthcare expenditure as a percentage of risk contributions (%)	61	77	76	91	53	N/A	**82**
Non-healthcare expenditure as a percentage of risk contributions (%)	18	24	24	23	19	N/A	**18**
Net healthcare result for the year	51 291	(11 499)	5 422	(348 345)	43 256	947	**187 179**
Net surplus/(deficit) for the year	56 375	71 500	44 500	(242 252)	50 969	947	**788 790**

Matters of non-compliance
for the year ended 31 December 2012

During the year the Scheme did not comply with the following sections and regulations of the Medical Schemes Act, No 131 of 1998, as amended:

Statutory Scheme solvency

In terms of Regulation 29(2) the Scheme must maintain accumulated funds expressed as a percentage of gross annual contributions for the accounting period under review which may be no less than 25%.

At 31 December 2012, the Scheme's accumulated funds expressed as a percentage of gross annual contributions was 23.41% (2011: 23.50%) which is less than the statutory requirement of 25%. The Scheme advised the Council for Medical Schemes during 2012 that one of the main reasons for this remains continuous high membership growth.

The Scheme has submitted a business plan to the Council for Medical Schemes in terms of Regulation 29(4) of the Medical Schemes Act, No 131 of 1998, as amended. The business plan provides that the Scheme will increase the statutory reserves to the required level of 25% by 31 December 2015. The business plan takes into account several assumptions such as membership growth, investment returns and medical inflation. The Council for Medical Schemes has approved the business plan with phase-in solvency levels as set out below.

Year ended	Solvency level
31 December 2012	22.3%
31 December 2013	23.0%
31 December 2014	24.3%
31 December 2015	25.4%

Sustainability of benefit plans

In terms of Section 33(2) of the Medical Schemes Act, No 131 of 1998, as amended, each plan is required to be self-supporting in terms of membership and financial performance and must be financially sound.

At 31 December 2012 the following benefit plans did not comply with Section 33(2):

Plan	Net underwriting deficit (excluding other income) R'000	Net (deficit)/surplus (including other income) R'000
Executive	(264 887)	(257 041)
Classic Comprehensive	(678 279)	(557 543)
Coastal Saver	(27 719)	71 500
Coastal Core	(2 267)	44 500
KeyCare Plus	(369 556)	(242 252)

Investments in employer groups

Section 35(8)(a) of the Medical Schemes Act, No 131 of 1998, as amended, states that a medical scheme shall not invest any of its assets in the business of an employer who participates in or any administrator or any arrangement associated with a medical scheme. Owing to the large number of the Scheme's employers being listed on the JSE, investments were made in certain of its employers listed on the JSE. The Council for Medical Schemes has granted the Scheme an exemption from this section of the Medical Schemes Act.

Contributions received after due date

Section 26(7) of the Medical Schemes Act, No 131 of 1998, as amended, states that all subscriptions or contributions shall be paid directly to a medical scheme not later than three days after payment thereof becoming due. There are instances where the Scheme received contributions after three days of becoming due. However, there are no contracts in place agreeing to this arrangement.

Broker fees paid before contributions are received

In terms of Regulation 28(5) of the Medical Schemes Act, No 131 of 1998, as amended, the Scheme broker fees must be paid monthly and on receipt by the Scheme of the relevant monthly contributions. In some instances brokers were compensated prior to receipt of the relevant monthly contributions. The Scheme has implemented additional controls to address this matter and continues to monitor the resulting instances where this requirement was contravened.