Abano Healthcare
Annual Report
2004

abano healthcare
group limited

MANAGING DIRECTOR'S REPORT

Year in review

Consolidation and investment in our infrastructure have been the key focuses for Abano Healthcare's senior management team in the 2003/04 year, as we ensure the Group is ably placed to maximise the opportunities in the medical and healthcare market in future years.

We have faced a number of challenges in the market this year, including increased compliance legislation, changes to funding bodies, contracts and policies as well as the rising costs of attracting, retaining and employing qualified staff. These challenges have stimulated a full and careful review of the performance of all our businesses and the future potential of each sector we operate within.

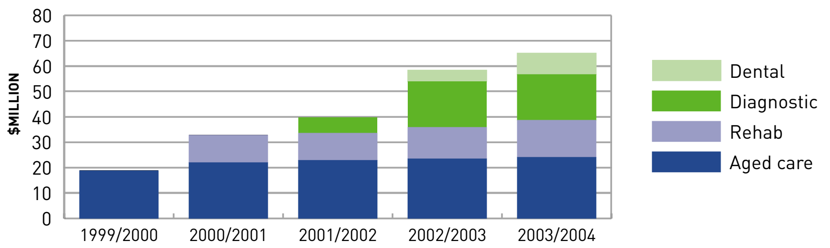
We have used the review to measure our progress and consolidate our position in those areas where strong future opportunities have been identified and where we believe we can add value and generate the best, long term sustainable returns for our shareholders.

Our progress to date has been in our ability to bring together businesses and provide synergies and improved efficiencies which have resulted in a better standard of care for our clients, and improved returns on our invested capital, thereby enhancing the consolidated position of the Group. We believe we are now well placed to take advantage of the growing demand for healthcare and medical services created by an ageing population, which will see the number of over 75 year olds grow by 30 percent in the next three years alone.

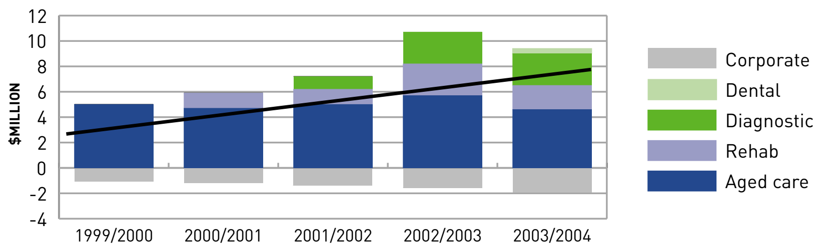
OPERATIONAL PERFORMANCE

The Group has increased revenues in each sector in the past financial year, with all sectors delivering positive operating performance at Op-EBITDA. On a consolidated basis, operating performance was down on the record result posted last year, but up on the previous year's result. The consolidated performance was affected by a decrease in contribution from Abano Aged Care following a decline in occupancy in rest homes, and a slowing in referrals and contract rate changes in Abano Rehabilitation.

OPERATING REVENUE

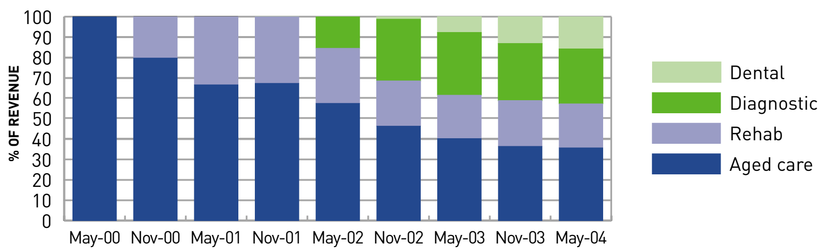


OPERATING EBITDA

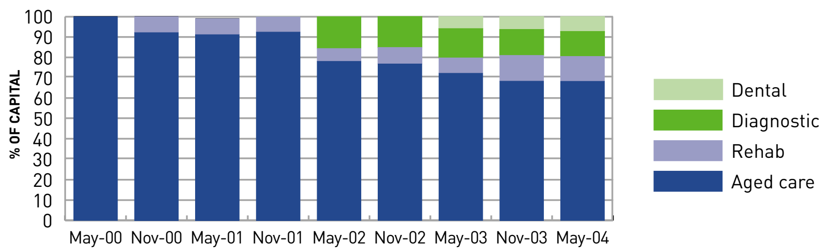


The Group's diversification of businesses continued and Aged Care operations are now reduced to 37 percent of Group activity, however, over 68 percent of total Group capital is still employed in this sector, as can be seen below.

REVENUE CONTRIBUTION BY SECTOR



CAPITAL EMPLOYED BY SECTOR



MANAGING DIRECTOR'S REPORT CONT

An overview of each sector is provided below, with detailed sector reports provided on pages 16 to 31. In all cases, operational EBITDA is reported for each sector (EBITDA before noncore/unusuals but after allocation of corporate costs).

Abano Aged Care

Revenues grew three percent to $24.1 million, with an Op-EBITDA contribution of $3.7 million, down 19 percent on last year but in line with previous years. Performance for the sector softened due to a sustained drop in rest home occupancy throughout the year, and an increase in compliance and employment legislation costs.

Abano Aged Care has focused on improving and upgrading facilities and services in the past year, as well as implementing an intensive quality programme to achieve Health and Disability Standards certification and ISO 9001:2000 accreditation. There has also been a significant investment in human resources, with the development and implementation of two new Career Pathways programmes.

Abano Dental

This is the first full twelve month contribution from Abano Dental. As forecast, the sector made a small contribution to overall Group performance with revenue at $8.3 million and Op-EBITDA of $0.1 million for the financial year.

Returns for the year were modest due to a significant investment in new software and financial systems. In addition, a new branch was opened at Auckland University and the number of chairs and operating dentist services were expanded in several surgeries.

In the year, we elected to close the small Geddes Dental Australian operation, as we focused management time, effort and investment into the New Zealand market. The closure incurred a one off cost write down of $0.33 million.

Abano Diagnostics

Abano Diagnostics performed well over the year, with revenue of $18.0 million, consistent with the previous year, and Op-EBITDA of $1.8 million slightly down on last year.

A new clinical management team was appointed following the retirement of Dr Clint Teague from his management role, and Dr Ken Thompson from his highly respected forensic practice.

Good progress has been made negotiating long term partnership contracts with DHBs, including involvement in a consultation process initiated by the Nelson Marlborough DHB to review all pathology services in the region, in both public and private sectors.

The analytical laboratory operation in Wellington is reporting a growing interest in environmental testing services, and new areas of testing are being explored.

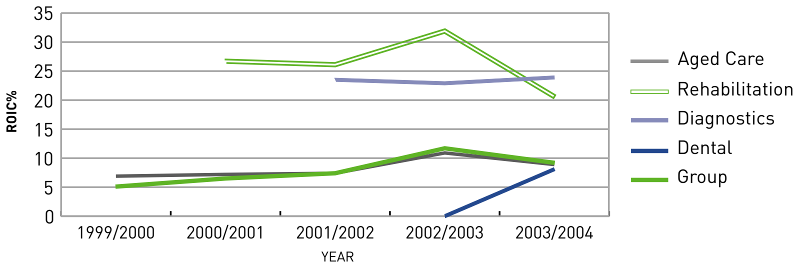
Abano Rehabilitation

The focus for Abano Rehabilitation in the past year has been on streamlining operations, developing synergies, improving IT functionality and driving earnings. Revenue for the financial year was up 16 percent to $14.4 million, however, EBITDA was $1.5 million, down 29 percent on last year, but significantly ahead of the year before.

The sector experienced a slow down in performance during the year, as contracts were re-negotiated and new contracting specifications were introduced by the ACC. Following the acquisition of two new businesses and the appointment of a new management team, Abano Rehabilitation underwent an operational review, resulting in a restructure of area management and their clinical teams to reduce costs and streamline delivery systems to meet new contract specifications.

Return on Invested Capital

The Group's progress with respect to the Return on Invested Capital at Operating EBITDA (before corporate overhead allocation) as a percentage of our investment in each business can be seen below.



* Each sector's ROIC is measured as Op-EBITDA (before corporate overhead) divided by the capital employed

** The Group ROIC is EBITDA (after corporate overhead) divided by the total capital employed

The graph shows that the less capital intensive sectors - Rehabilitation and Diagnostics – are generating returns on invested capital at Op-EBITDA, in the range of 15 to 25 percent. Dental, in an aggressive start up mode, returned close to 10 percent on a very modest operating profit in its first year, and the Aged Care sector, with its high capital intensity, generates returns in the range of seven to 12 percent.

Over the last five years, the Group has improved return on invested capital at Op-EBITDA from less than five percent in 2000, to just under ten percent this year. As we maintain our diversification strategy, we expect this improving trend to continue in the years ahead.

Our focus for the next financial year and beyond is to continue to develop our investment portfolio and improve the Group's overall return on invested capital. We will build on the investments and consolidation carried out in the 2003/04 financial year to improve our overall profitability, both organically and through acquisition of proven successful businesses.

MANAGING DIRECTOR'S REPORT CONT

OVERALL FINANCIAL POSITION

The Group's financial position remains sound at all key financial ratios.

KEY FINANCIAL RATIOS

$ MILLION	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
Debt/total assets	50.5	54.0	40.3	38.3	43.0
Equity/total assets	42.8	39.3	51.4	51.6	48.3
Interest cover at EBITDA	1.1x	0.97x	1.5x	2.7x	2.5x
EV/EBITDA	33.0	16.5	14.0	8.1	8.7

FINANCIAL POSITION

$ MILLION	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
Total assets	87.3	76.0	80.7	81.4	84.6
Net debt	44.1	41.1	32.5	32.4	36.4
Total equity	37.4	29.9	41.5	42.0	40.9

POTENTIAL SHARES ON ISSUE

	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
- Paid up shares on issue	150,771,725	157,032,387	193,681,527	194,835,832	219,953,744
- Options	33,034,274	33,034,274	31,034,274	nil	nil
- Exec convertible notes	Nil	3,800,000	6,225,000	6,725,000	6,725,000
- Other convertible notes	9,397,328	5,398,402	22,101,025	16,451,206	8,800,000
Potential total shares	**193,203,327**	**199,265,063**	**253,041,826**	**218,012,038**	**235,478,744**

The number of paid up shares on issue increased after conversion of the Cullen convertible note in November 2003 (18,561,337 shares), and the Medlab Series 2 note in February 2004 (6,243,150 shares).

The minority one-third share in Ranworth Healthcare was acquired in June 2003 for $3.3 million, with the 100 percent acquisition of Burtons Healthcare and Health Partners in July 2003, for $1.5 million.

SOURCES OF INCOME

Abano Healthcare's revenue strategy is to generate a mix of private versus public generated income.
The New Zealand Government continues to be the largest funder of healthcare and medical services, with a total 2004/2005 health funding package of $9.9 billion per year or 20 percent of total Government spending, in a market estimated at $12 billion per annum. The Government has pledged an additional 18 percent of new operational spending in health over the next four years, including demographic funding.

Overall, the Group's continued success is reliant on positive relationships with public health funding bodies and Government organisations, but we believe there will be an increasing component of private funding as Government funding is unable to meet future demand. We will always have a strong focus on Government initiatives in health and will continue to hold and operate services under Government contracts.

REVENUE BY SECTOR

	2003/2004	% OF GROUP	FUNDING % GOVT/PRIVATE
Aged Care	$24.1 million	37	52 DHBs / 48 Private
Rehabilitation	$14.4 million	22	90 ACC / 10 MOH / 0 Private
Diagnostics	$18.0 million	28	94 DHBs / 6 Private
Dental	$8.3 million	13	22 DHBs / 78 Private

INVESTMENT IN OUR RESOURCES

Advanced technology, leading edge equipment and highly skilled and experienced clinical staff continue to be key areas of investment for Abano Healthcare Group. As can be seen in the table below, investment in these resources for the 2003/2004 financial year was $2.1 million.

RESOURCE ($000)	DIAGNOSTICS	DENTAL	AGED CARE	REHABILITATION
Technology	155	480	91	218
Equipment	336	193	121	Nil
Human Resources	73	84	264	116

SOCIAL RESPONSIBILITY

We operate in many different communities around New Zealand and believe it is important to support those communities in ways that help us foster relationships with our clients, our staff and the people who live and work around us.

In the past financial year, we have undertaken a number of sponsorships and other initiatives in support of this belief:

- Geddes Dental Group has undertaken a three year sponsorship of the Hippo River at Auckland Zoo. The sponsorship has become an integrated part of the Geddes marketing image, and was announced in March 2004 (effective from 1 June 2004).
- Abano Dental is also a key sponsor of student team events at the University of Otago Dental School, helping to foster relationships with future dentists and dental technicians.

MANAGING DIRECTOR'S REPORT CONT

- Medical Laboratory Wellington has sponsored George Bridgewater, a talented young rower and the son of senior microbiologist, Philippa Bridgewater, who is competing in the Athens Olympics in August 2004.
- Abano Diagnostics makes regular contributions to local medical organisations benefiting the community, such as Wellington Free Ambulance and Westpac Trust helicopter.
- Abano Rehabilitation is a major supporter of the Brain Injury Association, both in Auckland and nationally.
- ElderCare is a participant in the DVFree programme offered by the Domestic Violence Centre to equip employers and employees to deal with problems associated with the intrusion of domestic violence into the workplace.
- Abano Corporate is an annual sponsor of the youth suicide prevention trust, KoruCare, and the Auckland Safer Streets campaign.

THE FUTURE

A direct relationship exists between healthcare, medical usage and the population's age. At Abano Healthcare Group, our long term business strategy is based on servicing the increasing demand for healthcare and medical services from New Zealand's ageing population, as well as meeting the growing expectation for improved access and high quality healthcare.

In New Zealand, more than 23 percent of the population is expected to be aged over 65 years by 2030, a total of approximately 1.1 million people. For every five years a person lives over the age of 65 years, the demand for and use of medical and healthcare services doubles; for people aged over 70 years, demand doubles every two years. An 85 year old uses 15 times more health dollars than a 50 year old and 85 year olds in our population will quadruple in the next five years.

We believe that the additional Government funding announced in the 2004 budget will be insufficient to meet the demands of an ageing population. In addition, as asset testing is removed over the next three years, Government expenditure for residential aged care alone will increase from approximately $520 million per annum to over $1.5 billion per annum, with a 15 percent growth rate per year predicted thereafter.

All OECD countries are facing the problem of funding the growing demand for healthcare and medical services, and it is expected that more and more Governments will transition part of this demand to private sources.

Our focus continues to be on the growing demand in the healthcare and medical services market and our clinical teams and management personnel have the experience and professionalism to ensure we maximise all opportunities and achieve our vision to be New Zealand's leading listed healthcare and medical services provider, positioned both for Government needs and growth in private health services.

We now have an established infrastructure at both sector and Group level, and operating businesses in four key medical and healthcare areas. Our priority for the next year is to enhance the performance of all businesses with improved returns to our shareholders.

Alan Clarke
MANAGING DIRECTOR