nib holdings

ASX Announcement

Date **Monday May 19 2008**

Subject **Estimated impact of proposed Medicare Levy Surcharge changes**

nib holdings limited (nib) today announced it had completed its internal analysis of the proposed Medicare Levy Surcharge changes and the possible impact on the business. nib will be monitoring the impact of this change on an ongoing basis.

nib's Managing Director, Mr Mark Fitzgibbon also reconfirmed guidance for FY08 that it had previously given with its interim results announced on 27 February 2008. In addition to confirming that nib expected to achieve in excess of 35,000 net new policyholders in FY08, Mr Fitzgibbon also said nib expected a normalised net underwriting margin of more than 3.0% for FY08.

"As we indicated on 12 May, we believe the changes to the Medicare Levy Surcharge will have an adverse impact on future sales and lapse rates for the industry," Mr Fitzgibbon said.

"However, we believe the primary drivers that make private health insurance so attractive still very much exist."

The level of private health insurance participation and growth is influenced by a number of factors, in addition to the Medicare Levy Surcharge. These include:

- Private health insurance's value proposition – the core value proposition of having private health insurance remains. People take out private health insurance to ensure they are more readily able to access hospital care and if necessary, choose a doctor for their hospital treatment. They also value how insurance cover on general treatment lessens the cost of accessing dental, optical and other general treatment.
- A crisis of confidence in the public hospital system and expectations of long waiting times for access and poor clinical quality.
- Increasing disposable income.
- 30% Federal Government Rebate incentive.
- Lifetime Health Cover (LHC) penalty loading – incentivising people to take up private health insurance by the age of 31.

"nib has been able to leverage these factors with product innovation, market positioning and innovative marketing to significantly grow our customer base and market share. We have grown at more than double the policyholder growth rate of the industry since 31 March 2006."

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Table: Private health insurance growth rates: nib has outgrown the industry

	31 March 2006	31 March 2008	Growth (Policyholders)	Growth (%)
Industry				
Policyholders – All	4,778,916	5,163,573	384,657	8.0%
Policyholders - Hospital	4,181,403	4,540,112	358,709	8.6%
Persons – All	10,160,708	10,868,214	707,506	7.0%
Persons – Hospital	8,829,427	9,476,921	647,494	7.3%
Persons – Hospital < 30	3,025,351	3,281,412	256,061	8.5%
Persons – Hospital > 30	5,804,076	6,195,509	391,433	6.7%
Nib				
Policyholders – All	299,212	358,370	59,158	19.8%
Policyholders - Hospital	270,302	326,413	56,111	20.8%
Persons – All	637,827	726,792	88,965	13.9%
Persons – Hospital	570,275	652,641	82,366	14.4%
Persons – Hospital < 30	217,261	254,160	36,899	17.0%
Persons – Hospital > 30	353,014	398,481	45,467	12.9%

The Private Health Insurance Administration Council's (PHIAC) March 2008 quarter results show nib's annual policyholder growth rate at 12.1% compared to the industry average of 4.9%. This is the 16th consecutive period nib has achieved above industry policyholder growth rates and for the March 2008 quarter, nib accounted for 15.6% of the total industry policyholder growth. Furthermore since March 2006 more than 55% (measured in hospital persons covered) of nib's growth has been in the over 30 years of age category.

Over the past week, nib has analysed the impact that the Government's proposed changes to the Medicare Levy Surcharge could have on its business going forward. We have given particular consideration to the following factors:

- policyholder age – those under 30 are more at risk as they can rejoin later by the age of 31 without penalty under LHC.
- product value – those who have bought lower cost products are more likely to have been motivated by tax considerations.
- income – many policyholders will remain over the new threshold.

The results of nib's analysis, which is broadly consistent with the report released by the AHIA yesterday, indicate that:

- additional 'shock loss' from the proposed changes in FY09 could be up to 6-8% equating to a one-off loss of approximately 25,000 policyholders.
- future new sales growth over the near term could be up to 13-17% lower than nib has been experiencing.
- ongoing policyholder percentage lapse rates beyond the initial shock lapse should be consistent with current experience.
- growth in premium revenue is expected to be in the mid to high single digits for FY09.

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- gross margin could be 0.5-1.5 percentage points lower than nib was anticipating prior to the change to the Medicare Levy Surcharge in the near term, including the forecast increase in the risk equalisation levy (relative to other benefits expenditure).
- assuming there were no major changes to nib's cost base, normalised net underwriting margin for FY09 will be near 2.5%.

While nib has invested much effort and resources since the Government announcement in order to make the above assessment, the company stresses there is no equivocal historical experience to guide the assessment and actual experience could well vary.

nib also confirmed that its organic growth marketing spend may in future be adjusted if required to reflect the impact of the Medicare Levy Surcharge decision and continue the pursuit of target net underwriting margin.

"We are currently monitoring the effectiveness of our marketing spend having regard to the possible increased Medicare Levy Surcharge impact, with the potential for this to be reduced in FY09.

"We continue to target a net underwriting margin of 5% and return on equity of at least 15%, and expect to reach these targets within four years."

As a result of the Government changes, nib is also reassessing its investment portfolio mix with a view to moving towards an 80:20 split of defensive and growth assets in the near term. This change will result in reduced volatility in FY09 investment income when compared to our experience during FY08.

Mr Fitzgibbon added he remained very positive about the industry's outlook and prospects, as well as nib's outlook and organic growth prospects.

"Fundamental to this situation is that the core value proposition for having private health insurance has not changed, especially given the ongoing crisis and lack of confidence in the public hospital system.

"In addition to our positive organic growth outlook, our ungeared balance sheet and strong excess capital position make us confident nib will play a leading role in likely future industry consolidation.

"We believe the changes to the Medicare Levy Surcharge will exert further pressure on the earnings and capital position of some health funds, particularly those more reliant on third party distribution and less on their brand and value proposition for their growth.

"In the wake of the recent overwhelming support from MBF members for its merger with BUPA, the industry is clearly becoming much more amenable to the idea of demutualisation and consolidation, and we believe these changes will only accelerate the need for increased scale."

nib confirmed it still expects to pay a distribution equal to 40-60% of normalised profits for FY08.

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