Raffles Medical Group

To Open a New Hospital In Chongqing In 2018

Yesterday, Raffles Medical announced that it will develop a new hospital in Chongqing, China which will have a capacity of 700 beds. The hospital, currently under construction, is expected to commence operations in phases from Aug 2018 onwards. While we make no changes to our forecast and TP at the moment – as management said that more details would only be given in 2Q17 – our early-stage forecast estimates this project to potentially add SGD1.12/share to Raffles Medical’s value, based on a progressive 5-year capacity ramp-up period. We keep our BUY call on the stock, with an unchanged TP of SGD1.72 (20% upside).

Chongqing is one of the fastest-growing municipalities. The new hospital will be in Chongqing, a municipality with over 30m in population and a gross state product CAGR of 7.4% for the next four years (based on BMI Research’s projections). According to management, there is no international hospital in Chongqing at the moment. Hence, the new facility would be poised to serve the higher- to middle-class locals and expatriates in the city.

Immense potential worth SGD1.12/share. Including the CNY188m consideration payable for the land and construction incurred, management expects the development to cost around CNY1b (SGD203m). As management has only provided limited details at this point, we estimate returns for this new hospital on a standalone basis. In our calculation, we imputed a 5-year ramp-up period as well as average inpatient and outpatient revenue of listed hospitals operating in China (Figure1). Assuming that Raffles Medical will own a 100% stake, we believe this hospital could add SGD1.12/share to our current TP of SGD1.72. Nevertheless, management said that if a suitable partner comes along, it may sell some of its holdings but retain a majority stake.

Reiterate BUY and a TP SGD1.72. We make no change to our estimates as we await more details from management in the next results briefing. While the new hospital is likely to incur some start-up expenses in FY18 and FY19, we believe in the long-term growth prospects of Raffles Medical as it has three new hospitals underway:

i. The Raffles Hospital extension, which is scheduled to kick off operations in 2H17;
ii. The opening of the Chongqing hospital in 2Q18;
iii. The opening of its Shanghai hospital in end-2018.

Forecasts and Valuations

<table>
<thead>
<tr>
<th></th>
<th>Dec-15</th>
<th>Dec-16</th>
<th>Dec-17F</th>
<th>Dec-18F</th>
<th>Dec-19F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total turnover (SGDm)</td>
<td>411</td>
<td>474</td>
<td>535</td>
<td>602</td>
<td>654</td>
</tr>
<tr>
<td>Reported net profit (SGDm)</td>
<td>69</td>
<td>70</td>
<td>86</td>
<td>103</td>
<td>116</td>
</tr>
<tr>
<td>Recurring net profit (SGDm)</td>
<td>68</td>
<td>68</td>
<td>86</td>
<td>103</td>
<td>116</td>
</tr>
<tr>
<td>Recurring net profit growth (%)</td>
<td>4.6</td>
<td>1.4</td>
<td>25.3</td>
<td>25.3</td>
<td>12.5</td>
</tr>
<tr>
<td>Recurring EPS (SGD)</td>
<td>0.12</td>
<td>0.04</td>
<td>0.05</td>
<td>0.06</td>
<td>0.07</td>
</tr>
<tr>
<td>DPS (SGD)</td>
<td>0.06</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>Recurring P/E (x)</td>
<td>12.1</td>
<td>36.5</td>
<td>29.1</td>
<td>24.2</td>
<td>21.5</td>
</tr>
<tr>
<td>P/B (x)</td>
<td>1.36</td>
<td>3.75</td>
<td>3.48</td>
<td>3.18</td>
<td>2.88</td>
</tr>
<tr>
<td>P/CF (x)</td>
<td>11.1</td>
<td>31.0</td>
<td>20.3</td>
<td>19.6</td>
<td>18.5</td>
</tr>
<tr>
<td>Dividend Yield (%)</td>
<td>4.2</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>EV/EBITDA (x)</td>
<td>4.7</td>
<td>21.3</td>
<td>16.8</td>
<td>13.6</td>
<td>11.6</td>
</tr>
<tr>
<td>Return on average equity (%)</td>
<td>12.0</td>
<td>11.0</td>
<td>12.4</td>
<td>13.7</td>
<td>14.1</td>
</tr>
<tr>
<td>Net debt to equity</td>
<td>net cash</td>
<td>net cash</td>
<td>net cash</td>
<td>net cash</td>
<td>net cash</td>
</tr>
<tr>
<td>Our vs consensus EPS (adjusted) (%)</td>
<td>(1.8)</td>
<td>(1.8)</td>
<td></td>
<td></td>
<td>10.7</td>
</tr>
</tbody>
</table>

Source: Company data, RHB

Consumer Non-cyclical | Healthcare

Buy (Maintained)

- Target Price: SGD1.72
- Price: SGD1.43
- Market Cap: USD1,791m
- Bloomberg Ticker: RFMD SP

Share Data
- Avg Daily Turnover (SGD/USD): 2.29m/1.62m
- 52-wk Price low/high (SGD): 1.39 - 1.63
- Free Float (%): 48
- Shares outstanding (m): 565
- Estimated Return: 20%

Shareholders (%)
- Raffles Medical Holdings Pte Ltd: 38.5
- Loo Choon Yong: 10.0
- Aberdeen Asset Management: 5.0

Share Performance (%)
- YTD: 0.0
- 1m: 1.1
- 3m: (0.4)
- 6m: (7.2)
- 12m: (5.5)

Source: Bloomberg

Analyst
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Source: Bloomberg

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Powered by the EFA Platform
Early-stage forecast for the Chongqing hospital

We used the average inpatient length of stay and average spending per inpatient and outpatient visit as well as the gross margins of listed hospitals operating in China to estimate the returns of Raffles’ Chongqing hospital. The listed hospital companies include Rici Healthcare (1526 HK, NR), Guangdong Kanghua Healthcare (3689 HK, NR) and China Resources Phoenix Healthcare (1515 HK, NR).

We assumed a 5-year capacity ramp-up period for the occupancy rate to reach 80%. From there, we expect Raffles Medical to record an EBIT margin of approximately 22%, which is the industry average in China for private hospitals operating at full capacity.

**Figure 1: Chongqing Hospital’s estimated revenue and profit (FY18F-22F)**

<table>
<thead>
<tr>
<th></th>
<th>FY18F</th>
<th>FY19F</th>
<th>FY20F</th>
<th>FY21F</th>
<th>FY22F</th>
<th>FY22F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensed beds</td>
<td>700</td>
<td>700</td>
<td>700</td>
<td>700</td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>Beds to commence in phases</td>
<td>250</td>
<td>250</td>
<td>500</td>
<td>500</td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>Occupancy rate</td>
<td>10%</td>
<td>45%</td>
<td>55%</td>
<td>85%</td>
<td>75%</td>
<td>80%</td>
</tr>
<tr>
<td>Number of beds in operation</td>
<td>26.0</td>
<td>112.5</td>
<td>275</td>
<td>425</td>
<td>525</td>
<td>560</td>
</tr>
<tr>
<td>Number of inpatient visits</td>
<td>905</td>
<td>3,911</td>
<td>9,560</td>
<td>14,774</td>
<td>18,250</td>
<td>19,467</td>
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<tr>
<td>Average spending per inpatient visit (CNY)</td>
<td>17,000</td>
<td>17,000</td>
<td>17,510</td>
<td>18,035</td>
<td>18,576</td>
<td>19,134</td>
</tr>
<tr>
<td>Number of outpatient visits</td>
<td>45,263</td>
<td>195,536</td>
<td>477,976</td>
<td>738,690</td>
<td>912,500</td>
<td>973,333</td>
</tr>
<tr>
<td>Average spending per outpatient visit (CNY)</td>
<td>400</td>
<td>412</td>
<td>424</td>
<td>437</td>
<td>450</td>
<td>464</td>
</tr>
<tr>
<td>Revenue (CNY m)</td>
<td>33.5</td>
<td>147.0</td>
<td>370.2</td>
<td>589.3</td>
<td>749.8</td>
<td>823.8</td>
</tr>
<tr>
<td>EBIT (CNY m)</td>
<td>-37.3</td>
<td>-42.7</td>
<td>28.1</td>
<td>85.7</td>
<td>149.9</td>
<td>179.5</td>
</tr>
<tr>
<td>EBIT margin</td>
<td>-111.3%</td>
<td>-29.0%</td>
<td>7.6%</td>
<td>14.5%</td>
<td>20.0%</td>
<td>21.8%</td>
</tr>
<tr>
<td>SGDCNY</td>
<td>4.94</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EBIT (SGD m)</td>
<td>-7.6</td>
<td>-8.5</td>
<td>5.6</td>
<td>17.1</td>
<td>30.0</td>
<td>35.9</td>
</tr>
</tbody>
</table>

Source: RHB

Valuation methodology

We use DCF (FCFF) methodology to value the Chongqing hospital project, assuming 55% of the development cost is funded using borrowings at 3.5% interest rate. We derived a value of SGD1.12 per share for this new project.

**Figure 2: DCF assumptions**

<table>
<thead>
<tr>
<th>(SGD m)</th>
<th>FY17F</th>
<th>FY18F</th>
<th>FY19F</th>
<th>FY20F</th>
<th>FY21F</th>
<th>FY22F</th>
<th>FY22F</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBIT*(1-tax)</td>
<td>0.0</td>
<td>-5.7</td>
<td>-6.4</td>
<td>4.2</td>
<td>12.9</td>
<td>22.5</td>
<td>26.9</td>
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<tr>
<td>CAPEX</td>
<td>-150.0</td>
<td>-52.5</td>
<td>-15.0</td>
<td>-10.0</td>
<td>-15.0</td>
<td>-5.0</td>
<td>-5.0</td>
</tr>
<tr>
<td>Dep &amp; Amort</td>
<td>5.0</td>
<td>5.5</td>
<td>5.8</td>
<td>6.0</td>
<td>6.2</td>
<td>6.4</td>
<td></td>
</tr>
<tr>
<td>Net change in working capital</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>FCFF</td>
<td>-150.0</td>
<td>-53.2</td>
<td>-15.9</td>
<td>0.0</td>
<td>3.9</td>
<td>23.7</td>
<td>28.3</td>
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<tr>
<td>PV</td>
<td>-143.1</td>
<td>-53.2</td>
<td>-15.9</td>
<td>0.0</td>
<td>3.9</td>
<td>23.7</td>
<td>2,251.7</td>
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<tr>
<td>Total discounted FCFF</td>
<td>2,067.1</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Deduct borrowings</td>
<td>110.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Equity</td>
<td>1,957.1</td>
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<td></td>
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<tr>
<td>Value/share</td>
<td>1.12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax rate</td>
<td>25%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WACC</td>
<td>4.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Cost of equity</td>
<td>7.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of debt</td>
<td>3.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>% equity</td>
<td>45%</td>
<td></td>
<td></td>
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<tr>
<td>% debt</td>
<td>55%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: RHB
Recommendation Chart

Source: RHB, Bloomberg
Raffles Medical Group

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