

27 February 2018

Consumer Non-cyclical | Healthcare

Raffles Medical Group

Neutral (Maintained)

Lacklustre Outlook Due To Prevailing Headwinds

Target Price: SGD1.02
 Price: SGD1.10
 Market Cap: USD1,475m
 Bloomberg Ticker: RFMD SP

Raffles Medical Group booked a FY17 PATMI of SGD70.8m, ie slightly below our estimate. This was from a slower-than-expected turnaround in MCH Holdings, a decline in its healthcare services revenue, as well as a longer-than-expected rent-free period for its Holland V Medical Centre. We trim FY18-19F earnings by 5-10% respectively, as existing headwinds still prevail. Stay NEUTRAL, with a SGD1.02 TP (from SGD1.10, 7% downside).

Share Data

Avg Daily Turnover (SGD/USD) 2.29m/1.72m
 52-wk Price low/high (SGD) 1.04 - 1.48
 Free Float (%) 48
 Shares outstanding (m) 565
 Estimated Return -7%

Margin for its healthcare services unit narrowed significantly. Although revenue from Raffles Medical's healthcare services unit dipped by only 1.6% YoY, pre-tax margin for the segment fell to 3.2% (from: 6.9%). The group attributed this to the decrease in the renewal of international healthcare plans, and increased price competition in the healthcare insurance side of the business. While Singapore's economy grew better than expected in 2017, we note that the hiring of expatriates has not recovered in a significant way. Thus, we believe near-term headwinds for its margins would persist.

Shareholders (%)

Raffles Medical Holdings Pte Ltd 38.5
 Loo Choon Yong 10.0
 Aberdeen Asset Management 5.0

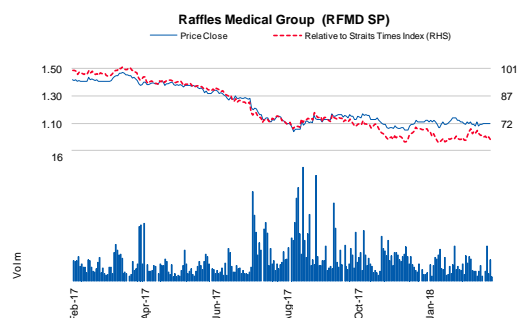
In addition, its China clinics (from its wholly-owned subsidiary, International SOS) have yet to turn around. Executive chairman Dr Loo Choon Yong said that the China clinics are still booking high staff costs of around 60-70% of revenue, which is much higher than that of Singapore's operations (50%).

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(1.8)	(3.5)	0.9	(4.4)	(23.6)
Relative	(5.6)	(1.9)	(2.3)	(12.8)	(36.2)

Source: Bloomberg

Foreign patient load remained soft but this was offset by the increase in local patients. The group announced that it has started a 5-year partnership with the Ministry of Health (MoH) to provide accessible and comprehensive family medical services, under the Primary Care Network (PCN) scheme. It has also been awarded the air borders screening contract by the MoH. We believe these new contracts would drive its local patient load, moving forward, and help to cover some fixed costs. However, overall, margins are likely to be lower, since these are subsidised services.



Source: Bloomberg

Rental boost is not immediate. We understand that 50% of the space in the new Raffles Hospital extension will be rented out to third parties. However, only 10% of the space has been leased by tenants currently. Certain levels of the building are still undergoing retrofitting works. In addition, the group is likely to give rent-free periods of 2-3 months to the tenants. As such, we now expect the bulk of the rental income from the new extension to only come in FY19.

Beijing and Shenzhen hospital projects are on hold. The opening of Raffles Medical's hospitals in Chongqing and Shanghai in China are scheduled for 4Q18 and 4Q19 respectively. As such, management hinted that plans for hospitals in Beijing and Shenzhen would be put on hold, until its Chongqing and Shanghai hospitals start contributing to group numbers.

Still a NEUTRAL stock. We cut our FY18-19F earnings by 5-10% respectively on the persistent headwinds, slower rental recognition, and upcoming start-up costs from the new hospitals. As such, our DCF-derived TP drops to SGD1.02.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (SGDm)	474	478	505	574	655
Reported net profit (SGDm)	70.2	71.4	66.0	62.4	65.1
Recurring net profit (SGDm)	68.7	71.4	66.0	62.4	65.1
Recurring net profit growth (%)	1.2	3.9	(7.6)	(5.4)	4.3
Recurring EPS (SGD)	0.04	0.04	0.04	0.04	0.04
DPS (SGD)	0.02	0.02	0.02	0.02	0.02
Recurring P/E (x)	28.0	26.9	29.1	30.8	29.5
P/B (x)	2.88	2.62	2.53	2.45	2.37
P/CF (x)	23.8	22.3	17.1	17.1	15.6
Dividend Yield (%)	1.8	2.0	2.0	2.0	2.0
EV/EBITDA (x)	15.4	16.0	14.4	13.5	12.2
Return on average equity (%)	11.1	10.2	8.8	8.1	8.2
Net debt to equity (%)	net cash	net cash	11.6	18.0	14.0
Our vs consensus EPS (adjusted) (%)			4.9	5.1	0.0

Source: Company data, RHB

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Financial Exhibits

Financial model updated on : 2018-02-26.

Asia	Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Singapore	Recurring EPS (SGD)	0.04	0.04	0.04	0.04	0.04
Consumer Non-cyclical	EPS (SGD)	0.04	0.04	0.04	0.04	0.04
Raffles Medical Group	DPS (SGD)	0.02	0.02	0.02	0.02	0.02
Bloomberg RFMD SP	BVPS (SGD)	0.38	0.42	0.44	0.45	0.46
Neutral	Weighted avg adjusted shares (m)	1,747	1,747	1,747	1,747	1,747
Valuation basis	Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
DCF	Recurring P/E (x)	28.0	26.9	29.1	30.8	29.5
	P/E (x)	27.4	26.9	29.1	30.8	29.5
	P/B (x)	2.88	2.62	2.53	2.45	2.37
	FCF Yield (%)	3.5	4.0	4.8	4.8	5.4
	Dividend Yield (%)	1.8	2.0	2.0	2.0	2.0
	EV/EBITDA (x)	15.4	16.0	14.4	13.5	12.2
	EV/EBIT (x)	18.1	19.0	18.3	18.6	17.6
Key drivers	Income statement (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
i. Improved economic outlook to boost healthcare demand;	Total turnover	474	478	505	574	655
ii. Higher-than-expected contributions from Chongqing Hospital and Shanghai Hospital	Gross profit	382	384	413	477	555
	EBITDA	97	96	102	105	111
	Depreciation and amortisation	(15)	(15)	(22)	(29)	(34)
	Operating profit	82	81	81	76	77
	Net interest	1	1	(3)	(4)	(4)
	Pre-tax profit	83	81	78	72	73
	Taxation	(15)	(12)	(14)	(13)	(13)
	Minority interests	2	2	2	3	5
	Recurring net profit	69	71	66	62	65
Key risks	Cash flow (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Longer-than-expected gestation periods	Change in working capital	(5)	3	33	24	29
	Cash flow from operations	81	86	112	113	123
	Capex	(14)	(10)	(20)	(20)	(20)
	Cash flow from investing activities	(44)	(141)	(184)	(130)	(60)
	Dividends paid	(14)	(14)	(39)	(39)	(39)
	Cash flow from financing activities	(8)	41	83	14	(34)
	Cash at beginning of period	86	112	98	110	106
	Net change in cash	28	(14)	11	(4)	29
	Ending balance cash	114	98	110	106	134
Company Profile	Balance sheet (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Raffles Medical Group Ltd owns and operates medical clinics in Singapore. The company operates through three segments: h	Total cash and equivalents	112	98	110	106	134
i. Healthcare services;	Tangible fixed assets	270	384	383	374	360
ii. Hospital services;	Intangible assets	31	37	37	37	37
iii. Investment Holdings.	Total investments	371	385	549	659	699
	Total other assets	5	4	5	5	5
	Total assets	901	1,006	1,168	1,272	1,331
	Short-term debt	13	41	50	50	50
	Total long-term debt	17	38	150	200	200
	Other liabilities	18	22	15	15	15
	Total liabilities	219	254	390	471	504
	Shareholders' equity	666	734	761	784	810
	Minority interests	15	18	18	18	18
	Total equity	682	752	778	801	827
	Net debt	(81)	(19)	90	144	116
	Total liabilities & equity	901	1,006	1,168	1,272	1,331
It owns and operates a network of family medicine clinics, a tertiary care private hospital, and an educational healthcare institute. The company was founded in 1976, and is based in Singapore.	Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Revenue growth (%)	15.4	0.8	5.8	13.6	14.1
	Recurrent EPS growth (%)	(67.0)	3.9	(7.6)	(5.4)	4.3
	Gross margin (%)	80.6	80.4	81.8	83.1	84.8
	Operating EBITDA margin (%)	20.4	20.0	20.3	18.3	16.9
	Net profit margin (%)	14.8	14.9	13.0	10.9	9.9
	Dividend payout ratio (%)	49.8	55.1	59.6	63.0	60.4
	Capex/sales (%)	3.1	2.1	4.0	3.5	3.1
	Interest cover (x)	(83.3)	(110.2)	27.0	19.1	19.3

Source: Company data, RHB

Figure 1: 4Q17 results summary

FYE Dec (SGD m)	4Q17	3Q17	QoQ (%)	4Q16	YoY (%)	Comments
Revenue	123.0	119.6	2.9	118.5	3.8	The increase in revenue from hospital services was offset by lower revenue in healthcare services
Staff costs	62.1	62.6	(0.9)	58.9	5.5	Due to efforts made by the group to reduce staff costs
% of revenue	50.5	52.4		49.7		
EBIT	24.0	18.4	30.7	24.7	(2.7)	Lower margins from healthcare services
EBIT Margin (%)	19.5	15.4		20.8		
Pretax profit	24.3	18.5	31.4	24.9	(2.5)	
Pretax Margin (%)	19.7	15.4		21.0		
Net Profit attributable	22.1	16.4	34.6	21.8	1.4	
Net Margin (%)	17.6	13.3		17.6		

Source: Company data, RHB

Visit to new Raffles Hospital extension

Raffles Hospital's extension commenced operations on 22 Jan 2018. With this extension, Dr Loo expects the company's hospital services revenue to grow at a high single-digit rate this year.

We visited the extension to get a closer look at the newly-opened clinics. We note that Ward 8 (obstetrics & gynaecology, and paediatrics) and Ward 9 (medical and surgical services) were fairly crowded on a week day. We believe the high single-digit growth in hospital services revenue could be achieved. However, operating costs are likely to run ahead of revenue.

Management expects to use approximately 45-50% of the space for its operations, and rent out the remaining 50%. We understand that levels B1 to 3 would be rented out mainly to food & beverage players. Levels 14 to 19 seem to still be undergoing retrofitting works, at the same time. Currently, only 10% of the space has been committed to by tenants.

Furthermore, the group is likely to give tenants rent-free periods lasting 2-3 months. As such, we expect the bulk of the rental income to be recognised in FY19.

Figure 1: Ward 8 for obstetrics & gynaecology and paediatrics



Source: RHB

Figure 2: Ward 9 for medical and surgical services



Source: RHB

Figure 4: Level 14 is still undergoing retrofitting works



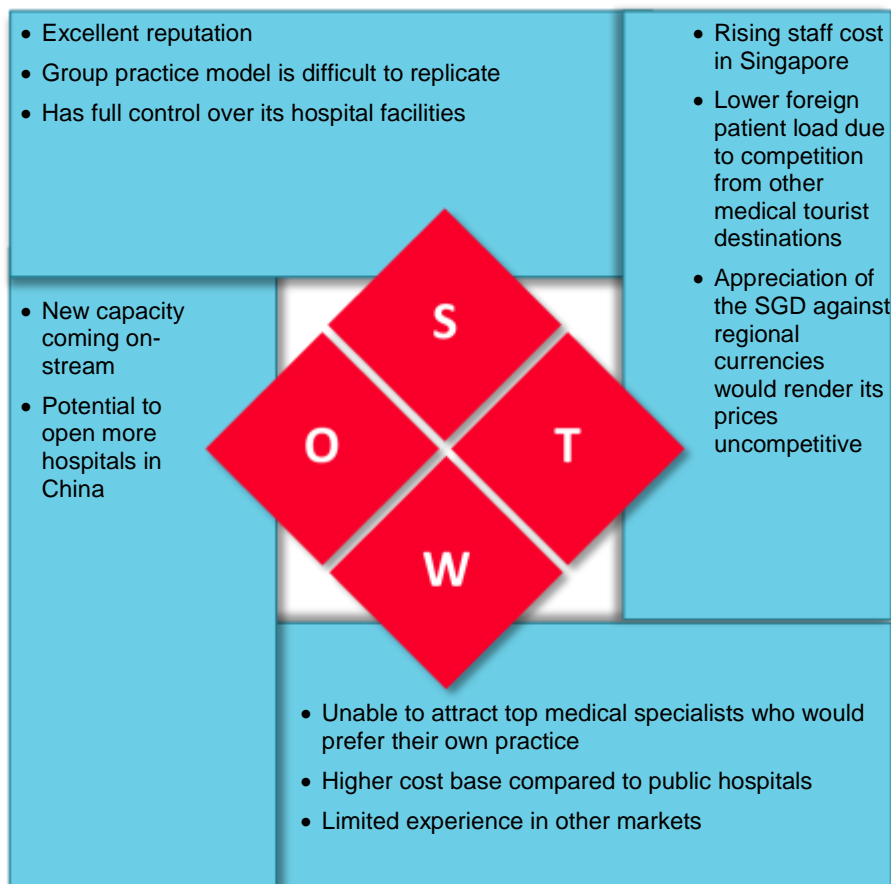
Source: RHB

Figure 5: DCF assumptions

SGDm	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F
Net income	66.0	62.4	65.1	68.0	76.5	84.9
+ Non-cash charges	21.5	28.7	33.6	32.0	32.0	32.0
+ Fixed capital investment	(184.2)	(130.0)	(60.0)	(30.0)	(30.0)	(30.0)
+ Change in net working capital	33.4	24.5	29.1	20.0	10.0	5.0
+ Change in debt	120.8	50.0	0.0	(5.0)	(5.0)	(5.0)
FCFE	57.4	35.6	67.8	85.0	83.5	86.9
Terminal Value						2,278.1
PV	53.5	28.7	50.9	59.4	54.3	1,536.7
Total discounted FCFE	1,783.4					
Value per share (SGD)	1.02					
Cost of equity	7.5%					
Risk-free rate	2.8%					
Beta	0.75					
Market return	9.0%					
Terminal growth	3.5%					

Source: RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-10-31	Neutral	1.10	1.13
2017-08-01	Sell	1.10	1.21
2017-04-25	Neutral	1.49	1.39
2017-04-04	Buy	1.72	1.45
2017-02-20	Buy	1.72	1.46
2016-10-24	Buy	1.76	1.51
2016-07-26	Buy	1.70	1.55
2016-02-23	Buy	1.70	1.45
2015-10-27	Buy	1.80	1.45
2015-07-27	Buy	1.83	1.62

Source: RHB, Bloomberg

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