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).

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.

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%).

Foreign patient load remained soft but this was offset by the increase in local patients. The group announced that it 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.

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.
### Financial Exhibits


**Asia**

**Singapore**

**Consumer Non-cyclical**

**Raffles Medical Group**

**Bloomberg** RFMD SP

**Neutral**

#### Valuation basis

**DCF**

#### Key drivers

1. Improved economic outlook to boost healthcare demand;
2. Higher-than-expected contributions from Chongqing Hospital and Shanghai Hospital

#### Key risks

- Longer-than-expected gestation periods

### Company Profile

Raffles Medical Group Ltd owns and operates medical clinics in Singapore. The company operates through three segments: 
1. Healthcare services;
2. Hospital services;
3. Investment Holdings.

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.

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#### Financial summary

<table>
<thead>
<tr>
<th></th>
<th>Dec-16</th>
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<td>Recurring EPS (SGD)</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
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<tr>
<td>EPS (SGD)</td>
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<td>BVPS (SGD)</td>
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<td>Weighed avg adjusted shares (m)</td>
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#### Valuation metrics

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<th>Dec-20F</th>
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<tbody>
<tr>
<td>Recurring P/E (x)</td>
<td>28.0</td>
<td>26.9</td>
<td>29.1</td>
<td>30.8</td>
<td>29.5</td>
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<tr>
<td>P/E (x)</td>
<td>27.4</td>
<td>26.9</td>
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<td>29.5</td>
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<tr>
<td>P/B (x)</td>
<td>2.88</td>
<td>2.62</td>
<td>2.53</td>
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<td>FCF Yield (%)</td>
<td>3.5</td>
<td>4.0</td>
<td>4.8</td>
<td>4.8</td>
<td>5.4</td>
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<tr>
<td>Dividend Yield (%)</td>
<td>1.8</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
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<tr>
<td>EV/EBITDA (x)</td>
<td>15.4</td>
<td>16.0</td>
<td>14.4</td>
<td>13.5</td>
<td>12.2</td>
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<td>EV/EBIT (x)</td>
<td>18.1</td>
<td>19.0</td>
<td>18.3</td>
<td>18.6</td>
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#### Income statement (SGDm)

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<tr>
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<th>Dec-18F</th>
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<tr>
<td>Total turnover</td>
<td>474</td>
<td>478</td>
<td>505</td>
<td>574</td>
<td>655</td>
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<tr>
<td>Gross profit</td>
<td>382</td>
<td>384</td>
<td>413</td>
<td>477</td>
<td>555</td>
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<tr>
<td>EBITDA</td>
<td>97</td>
<td>96</td>
<td>102</td>
<td>105</td>
<td>111</td>
</tr>
<tr>
<td>Depreciation and amortisation</td>
<td>(15)</td>
<td>(15)</td>
<td>(22)</td>
<td>(29)</td>
<td>(34)</td>
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<tr>
<td>Operating profit</td>
<td>82</td>
<td>81</td>
<td>81</td>
<td>76</td>
<td>77</td>
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<tr>
<td>Net interest</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>4</td>
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<tr>
<td>Pre-tax profit</td>
<td>83</td>
<td>81</td>
<td>78</td>
<td>72</td>
<td>73</td>
</tr>
<tr>
<td>Taxation</td>
<td>(15)</td>
<td>(12)</td>
<td>(14)</td>
<td>(13)</td>
<td>(13)</td>
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<tr>
<td>Minority interests</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>5</td>
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<tr>
<td>Recurring net profit</td>
<td>69</td>
<td>71</td>
<td>66</td>
<td>62</td>
<td>65</td>
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#### Cash flow (SGDm)

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<th>Dec-17</th>
<th>Dec-18F</th>
<th>Dec-19F</th>
<th>Dec-20F</th>
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<tbody>
<tr>
<td>Change in working capital</td>
<td>(5)</td>
<td>3</td>
<td>33</td>
<td>24</td>
<td>29</td>
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<tr>
<td>Cash flow from operations</td>
<td>81</td>
<td>86</td>
<td>112</td>
<td>113</td>
<td>123</td>
</tr>
<tr>
<td>Capex</td>
<td>(14)</td>
<td>(10)</td>
<td>(20)</td>
<td>(20)</td>
<td>(20)</td>
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<tr>
<td>Cash flow from investing activities</td>
<td>(44)</td>
<td>(141)</td>
<td>(184)</td>
<td>(130)</td>
<td>(60)</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>(14)</td>
<td>(14)</td>
<td>(39)</td>
<td>(39)</td>
<td>(39)</td>
</tr>
<tr>
<td>Cash flow from financing activities</td>
<td>(8)</td>
<td>41</td>
<td>83</td>
<td>14</td>
<td>(34)</td>
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<tr>
<td>Cash at beginning of period</td>
<td>86</td>
<td>112</td>
<td>98</td>
<td>110</td>
<td>106</td>
</tr>
<tr>
<td>Net change in cash</td>
<td>28</td>
<td>(14)</td>
<td>11</td>
<td>(4)</td>
<td>29</td>
</tr>
<tr>
<td>Ending balance cash</td>
<td>114</td>
<td>98</td>
<td>110</td>
<td>106</td>
<td>134</td>
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</table>

#### Balance sheet (SGDm)

<table>
<thead>
<tr>
<th></th>
<th>Dec-16</th>
<th>Dec-17</th>
<th>Dec-18F</th>
<th>Dec-19F</th>
<th>Dec-20F</th>
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</thead>
<tbody>
<tr>
<td>Total cash and equivalents</td>
<td>112</td>
<td>98</td>
<td>110</td>
<td>106</td>
<td>134</td>
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<tr>
<td>Intangible fixed assets</td>
<td>270</td>
<td>384</td>
<td>383</td>
<td>374</td>
<td>360</td>
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<tr>
<td>Intangible assets</td>
<td>31</td>
<td>37</td>
<td>37</td>
<td>37</td>
<td>37</td>
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<tr>
<td>Total investments</td>
<td>371</td>
<td>385</td>
<td>549</td>
<td>659</td>
<td>699</td>
</tr>
<tr>
<td>Total other assets</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Total assets</td>
<td>901</td>
<td>1,006</td>
<td>1,168</td>
<td>1,272</td>
<td>1,331</td>
</tr>
<tr>
<td>Short-term debt</td>
<td>13</td>
<td>41</td>
<td>50</td>
<td>50</td>
<td>50</td>
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<tr>
<td>Total long-term debt</td>
<td>17</td>
<td>38</td>
<td>150</td>
<td>200</td>
<td>200</td>
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<tr>
<td>Other liabilities</td>
<td>18</td>
<td>22</td>
<td>15</td>
<td>15</td>
<td>15</td>
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<tr>
<td>Total liabilities</td>
<td>219</td>
<td>254</td>
<td>390</td>
<td>471</td>
<td>504</td>
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<tr>
<td>Shareholders’ equity</td>
<td>666</td>
<td>734</td>
<td>761</td>
<td>784</td>
<td>810</td>
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<tr>
<td>Minority interests</td>
<td>15</td>
<td>18</td>
<td>18</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td>Total equity</td>
<td>682</td>
<td>752</td>
<td>778</td>
<td>801</td>
<td>827</td>
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<tr>
<td>Net debt</td>
<td>(81)</td>
<td>(19)</td>
<td>90</td>
<td>144</td>
<td>116</td>
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<tr>
<td>Total liabilities &amp; equity</td>
<td>901</td>
<td>1,006</td>
<td>1,168</td>
<td>1,272</td>
<td>1,331</td>
</tr>
</tbody>
</table>

#### Key metrics

<table>
<thead>
<tr>
<th></th>
<th>Dec-16</th>
<th>Dec-17</th>
<th>Dec-18F</th>
<th>Dec-19F</th>
<th>Dec-20F</th>
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</thead>
<tbody>
<tr>
<td>Revenue growth (%)</td>
<td>15.4</td>
<td>0.8</td>
<td>5.8</td>
<td>13.6</td>
<td>14.1</td>
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<tr>
<td>Recurrent EPS growth (%)</td>
<td>(67.0)</td>
<td>3.9</td>
<td>(7.6)</td>
<td>(5.4)</td>
<td>4.3</td>
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<tr>
<td>Gross margin (%)</td>
<td>80.6</td>
<td>80.4</td>
<td>81.8</td>
<td>83.1</td>
<td>84.8</td>
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<tr>
<td>Operating EBITDA margin (%)</td>
<td>20.4</td>
<td>20.0</td>
<td>20.3</td>
<td>18.3</td>
<td>16.9</td>
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<tr>
<td>Net profit margin (%)</td>
<td>14.8</td>
<td>14.9</td>
<td>13.0</td>
<td>10.9</td>
<td>9.9</td>
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<tr>
<td>Dividend payout ratio (%)</td>
<td>49.8</td>
<td>55.1</td>
<td>59.6</td>
<td>63.0</td>
<td>60.4</td>
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<tr>
<td>Capex/sales (%)</td>
<td>3.1</td>
<td>2.1</td>
<td>4.0</td>
<td>3.5</td>
<td>3.1</td>
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<tr>
<td>Interest cover (x)</td>
<td>(83.3)</td>
<td>(110.2)</td>
<td>27.0</td>
<td>19.1</td>
<td>19.3</td>
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</table>

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 weekday. 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

Figure 2: Ward 9 for medical and surgical services
**Figure 4: Level 14 is still undergoing retrofitting works**

![Image](image_url)

*Source: RHB*

**Figure 5: DCF assumptions**

<table>
<thead>
<tr>
<th>SGDm</th>
<th>FY18F</th>
<th>FY19F</th>
<th>FY20F</th>
<th>FY21F</th>
<th>FY22F</th>
<th>FY23F</th>
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<tbody>
<tr>
<td>Net income</td>
<td>66.0</td>
<td>62.4</td>
<td>65.1</td>
<td>68.0</td>
<td>76.5</td>
<td>84.9</td>
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<tr>
<td>+ Non-cash charges</td>
<td>21.5</td>
<td>28.7</td>
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<td>32.0</td>
<td>32.0</td>
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<tr>
<td>+ Fixed capital investment</td>
<td>(184.2)</td>
<td>(130.0)</td>
<td>(60.0)</td>
<td>(30.0)</td>
<td>(30.0)</td>
<td>(30.0)</td>
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<tr>
<td>+ Change in net working capital</td>
<td>33.4</td>
<td>24.5</td>
<td>29.1</td>
<td>20.0</td>
<td>10.0</td>
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<tr>
<td>+ Change in debt</td>
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<td>(5.0)</td>
<td>(5.0)</td>
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<td>FCFE</td>
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<td>Terminal Value</td>
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<td>PV</td>
<td>53.5</td>
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<td>50.9</td>
<td>59.4</td>
<td>54.3</td>
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<td>Total discounted FCFE</td>
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<td>Value per share (SGD)</td>
<td>1.02</td>
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</table>

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

- Excellent reputation
- Group practice model is difficult to replicate
- Has full control over its hospital facilities

- Rising staff cost in Singapore
- Lower foreign patient load due to competition from other medical tourist destinations
- Appreciation of the SGD against regional currencies would render its prices uncompetitive
- New capacity coming on-stream
- Potential to open more hospitals in China

- Unable to attract top medical specialists who would prefer their own practice
- Higher cost base compared to public hospitals
- Limited experience in other markets

Recommendation Chart

- Buy
- Neutral
- Sell
- Trading Buy
- Take Profit
- Not Rated

Source: RHB, Bloomberg
RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral: Share price may fall within the range of +/- 10% over the next 12 months
Take Profit: Target price has been attained. Look to accumulate at lower levels
Sell: Share price may fall by more than 10% over the next 12 months
Not Rated: Stock is not within regular research coverage

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