

25 April 2017

Consumer Non-cyclical | Healthcare

## Raffles Medical Group

**Neutral** (from Buy)

### Near-Term Headwinds

We downgrade Raffles Medical to **NEUTRAL** (from Buy), lowering TP to SGD1.49 (from SGD1.72, 5% upside), on stronger headwinds. While we are positive on Raffles Medical's medium-term outlook, with two new hospitals coming on stream in China, we are now more cautious about Singapore's healthcare scene. 1Q17 results were hit by softer-than-expected foreign patient load. As a result, revenue was down 2% YoY, below management's full-year guidance of 10% growth.

**Rental booster to come from 2Q17 onwards.** Rental income from Raffles Holland Village would only contribute more significantly next quarter onwards. According to management, they had given tenants a rent-free period for up to two months. Since most of the tenants only signed towards the end of last year, the rental income would only kick in next quarter.

**Raffles hospital extension likely to open only next year.** Management guided that the Raffles hospital extension would be completed by 4Q17. However, based on our channel checks, we think this is likely to be operational only next year. This may not be a bad thing, given the current weak demand from foreign patients.

**NEUTRAL for now.** We cut our FY17F-19F earnings by 10-13%, on the weaker healthcare outlook in Singapore. This results in a lower DCF-derived TP of SGD1.49 (Figure 1). At the moment, we have not factored Chongqing hospital into our numbers.

### 1Q17 earnings announced 24 Apr 2017 – below expectations

FYE Dec (SGDm)	1Q17	1Q16	YoY (%)	Comments
<b>Revenue</b>	<b>114.9</b>	<b>116.9</b>	<b>(1.7)</b>	Hospital services down 1.9% YoY, healthcare down 2% YoY, mainly due to weaker foreign patient-load.
<b>EBIT</b>	<b>18.1</b>	<b>18.7</b>	<b>(3.4)</b>	Mainly due to lower wage credit received. Excluding wage credit, received EBIT would be up 3.8%.
Operating Margin (%)	15.7	16.0		
<b>PATMI</b>	<b>15.5</b>	<b>15.5</b>	<b>0.1</b>	Improved net margin on better cost containment.
Net Margin (%)	13.5	13.3		

Source: Company data, RHB

**Beyond the immediate headwinds, we are still very positive on the medium-term outlook of Raffles Medical.** Unfortunately, management has provided very limited information on Chongqing hospital at this point. Hence, we have not imputed Chongqing hospital into our forecast. Based on the information available, our back-of-envelope DCF valuation suggests that the Chongqing hospital project could add an additional SGD1.10/share to our current TP on a bull case scenario. Even in a bear-case scenario, we believe this project to be accretive at SGD0.37/share.

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (SGDm)	411	474	491	544	616
Reported net profit (SGDm)	69	70	76	89	102
Recurring net profit (SGDm)	68	69	76	89	102
Recurring net profit growth (%)	5.0	1.2	10.0	18.2	13.9
Recurring EPS (SGD)	0.12	0.04	0.04	0.05	0.06
DPS (SGD)	0.06	0.02	0.02	0.02	0.02
Recurring P/E (x)	11.9	36.0	32.7	27.7	24.3
P/B (x)	1.35	3.71	3.50	3.25	2.98
P/CF (x)	10.9	30.6	23.6	22.6	20.3
Dividend Yield (%)	4.2	1.4	1.4	1.4	1.4
EV/EBITDA (x)	4.6	21.1	19.0	15.6	13.5
Return on average equity (%)	12.1	11.1	11.0	12.2	12.8
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			0.6	4.4	(1.3)

Source: Company data, RHB

Target Price:	SGD1.49
Price:	SGD1.42
Market Cap:	USD1,780m
Bloomberg Ticker:	RFMD SP

### Share Data

Avg Daily Turnover (SGD/USD)	2.59m/1.84m
52-wk Price low/high (SGD)	1.39 - 1.63
Free Float (%)	48
Shares outstanding (m)	565
Estimated Return	5%

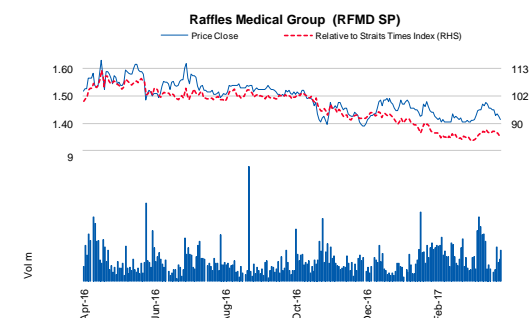
### Shareholders (%)

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

### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(1.1)	0.4	(2.1)	(6.0)	(7.5)
Relative	(10.2)	0.4	(5.5)	(16.1)	(14.4)

Source: Bloomberg



Source: Bloomberg

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## Financial Exhibits

Financial model updated on : 2017-04-24.

Asia	<b>Financial summary</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
Singapore	Recurring EPS (SGD)	0.12	0.04	0.04	0.05	0.06
Consumer Non-cyclical	EPS (SGD)	0.12	0.04	0.04	0.05	0.06
<b>Raffles Medical Group</b>	DPS (SGD)	0.06	0.02	0.02	0.02	0.02
Bloomberg RFMD SP	BVPS (SGD)	1.05	0.38	0.40	0.44	0.47
<b>Neutral</b>	Weighted avg adjusted shares (m)	570	1,747	1,747	1,747	1,747
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
DCF	Recurring P/E (x)	11.9	36.0	32.7	27.7	24.3
	P/E (x)	11.6	35.2	32.7	27.7	24.3
	P/B (x)	1.35	3.71	3.50	3.25	2.98
<b>Key drivers</b>	FCF Yield (%)	4.9	2.7	3.4	3.6	4.1
i. Improved economic outlook to boost healthcare demand;	Dividend Yield (%)	4.2	1.4	1.4	1.4	1.4
ii. Higher-than-expected contributions from Chongqing Hospital and Shanghai Hospital.	EV/EBITDA (x)	4.6	21.1	19.0	15.6	13.5
	EV/EBIT (x)	5.3	24.8	22.2	17.9	15.3
<b>Key risks</b>	<b>Income statement (SGDm)</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
Longer-than-expected gestation periods.	Total turnover	411	474	491	544	616
	Gross profit	329	382	399	445	504
	EBITDA	93	97	104	123	137
	Depreciation and amortisation	(13)	(15)	(15)	(15)	(16)
	Operating profit	81	82	89	108	122
	Net interest	1	1	0	(0)	(1)
	Pre-tax profit	82	83	90	108	121
	Taxation	(13)	(15)	(16)	(19)	(22)
	Minority interests	0	2	2	1	3
	Recurring net profit	68	69	76	89	102
	<b>Cash flow (SGDm)</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
	Change in working capital	(10)	(5)	19	6	7
	Cash flow from operations	74	81	105	109	122
	Capex	(35)	(14)	(20)	(20)	(20)
	Cash flow from investing activities	(178)	(44)	(133)	(83)	(70)
	Dividends paid	(12)	(14)	(35)	(35)	(35)
	Cash flow from financing activities	28	(8)	(8)	(34)	(12)
	Cash at beginning of period	150	86	112	75	67
	Net change in cash	(77)	28	(37)	(8)	39
	Ending balance cash	74	114	75	67	107
	<b>Balance sheet (SGDm)</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
	Total cash and equivalents	86	112	75	67	107
	Tangible fixed assets	264	270	275	280	284
	Intangible assets	32	31	31	31	31
	Total investments	344	371	485	548	598
	Total other assets	4	5	5	5	5
	Total assets	815	901	955	1,024	1,131
	Short-term debt	11	13	15	15	15
	Total long-term debt	21	17	40	40	60
	Other liabilities	15	18	15	15	15
	Total liabilities	193	219	233	247	287
	Shareholders' equity	603	666	707	761	828
	Minority interests	19	15	15	15	15
	Total equity	622	682	722	777	844
	Net debt	(54)	(81)	(20)	(12)	(32)
	Total liabilities & equity	815	901	955	1,024	1,131
	<b>Key metrics</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
	Revenue growth (%)	9.6	15.4	3.7	10.7	13.3
	Recurrent EPS growth (%)	3.0	(67.0)	10.0	18.2	13.9
	Gross margin (%)	80.2	80.6	81.3	81.8	81.8
	Operating EBITDA margin (%)	22.8	20.4	21.3	22.7	22.3
	Net profit margin (%)	16.9	14.8	15.4	16.4	16.5
	Dividend payout ratio (%)	49.8	49.8	46.2	39.1	34.3
	Capex/sales (%)	8.4	3.1	4.1	3.7	3.2
	Interest cover (x)	(80.4)	(83.3)	(262.9)	1,078.3	243.1

Source: Company data, RHB

Figure 1: DCF assumptions for Raffles Medical excluding Chongqing numbers

SGDm	FY17F	FY18F	FY19F	FY20F	FY21F	FY22F
Net income	75.6	89.3	101.8	118.1	135.8	154.8
+ Non-cash charges	15.1	15.4	15.6	18.0	20.0	20.0
+ Fixed capital investment	(133.2)	(83.3)	(70.0)	(30.0)	(20.0)	(20.0)
+ Change in net working capital	18.8	5.7	7.1	3.0	3.0	3.0
+ Change in debt	24.6	0.0	20.0	(40.0)	(40.0)	(5.5)
<b>FCFE</b>	<b>1.0</b>	<b>27.1</b>	<b>74.4</b>	<b>69.1</b>	<b>98.8</b>	<b>152.3</b>
Terminal Value						3,524.7
PV	0.9	23.5	60.0	51.8	69.0	2,389.2
Total discounted FCFE	2,594.4					
Value/share (SGD)	1.49					
Cost of equity	7.5%					
Risk-free rate	2.8%					
Beta	0.75					
Market return	9.0%					
Terminal growth	3.0%					

Source: RHB

### New updates on Chongqing hospital

**To open in phases.** According to management, the Chongqing hospital would be open in stages. In Phase 1, the hospital would commence operations with 200 beds in 2H18. Chairman, Dr Loo Choon Yong mentioned that he would not increase the number of beds until the hospital has hit 75% utilisation rate.

An additional 100 beds would also be opened, at the same time, to be used for public healthcare, where residents could pay with their national healthcare insurance. These 100 beds are likely to provide some form of base revenue to cover some of the fixed cost. Dr Loo said that he is happy if the 100 beds break even. As such, we imputed 0 EBIT in our early-stage forecast for Chongqing.

We believe Raffles Medical is likely to use these 100 public healthcare beds as a training ground for Raffles Medical to instil its culture into locally hired doctors.

Figure 2: New information acquired on Chongqing from the analyst briefing

Assumptions for revenue model		Comments
Average inpatient spending per day (CNY)	22,420	Management expects revenue per bed to not be lower than that in Singapore. In our assumption, we use Raffles Hospital's average inpatient bill size in Singapore.
Expected length of stay	6 days	In Singapore, the average length of stay for Raffles Hospital is three days, while the average length of stay in the public hospitals in China is 12 days. Management believes that the average length of stay in their hospitals in China would be around 6 days.
Capex (CNY)	1bn	Management guides that capex would be around CNY1bn inclusive of land, building and equipment.

Source: Company, RHB

◆ “We either succeed gloriously or fail miserably” – Dr Loo on Raffles Medical's venture into China.

### Blue sky scenario

According to Raffles Hospital's history, the hospital was opened in 2001 and was able to turn cash flow positive in 11 months. By the time it was listed in 2004, it was making a pretax margin of 10%.

In our bull-case scenario (Figures 3 and 4), we expect Raffles Medical to manage Chongqing hospital efficiently like the Raffles Hospital in Singapore, thereby making positive operating profit, and an EBIT margin of 13.3% in FY20F. Our standalone DCF valuation estimates the Chongqing hospital to be worth SGD1.10 per share in this blue-sky scenario.

◆ Our early-stage forecast of a "glorious" success obtains a value of SGD1.10 per share for the Chongqing Hospital.

Figure 3: Revenue assumption in bull case

	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	Comment
Licensed beds	700	700	700	700	700	700	
Beds to commence in phases	200	200	450	450	600	600	Excludes 100 beds used for public healthcare
Occupancy rate	13%	56%	60%	75%	65%	75%	
Number of inpatient visits	659	6,813	16,425	20,531	23,725	27,375	
Average spending per inpatient visit (CNY)	22,420	22,420	23,093	23,785	24,499	25,234	
Number of outpatient visits	6,590	68,133	164,250	205,313	237,250	273,750	Using ratio of 10 outpatients to 1 inpatient based on Singapore public hospital ratio, provided by Ministry of Health data.
Average spending per outpatient visit (CNY)	400	412	424	437	450	464	Using China peers' average outpatient spending
Revenue (CNYm)	17.4	180.8	449.0	578.1	688.0	817.7	
EBIT (CNYm)	-43.9	-31.3	59.6	81.2	125.2	177.1	
EBIT margin	-252.2%	-17.3%	13.3%	14.1%	18.2%	21.7%	
SGD/CNY	4.94						
EBIT (SGDm)	-8.9	-6.3	11.9	16.2	25.0	35.4	

Source: RHB

Figure 4: DCF assumptions in bull case

	FY17F	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F
EBIT*(1-tax)	0.0	-6.7	-4.7	8.9	12.2	18.8	26.6
Capex	-150.0	-52.5	-15.0	-10.0	-15.0	-5.0	-5.0
Dep & Amort		5.0	5.5	5.8	6.0	6.2	6.4
Net change in working capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCFF	-150.0	-54.2	-14.2	4.7	3.2	20.0	28.0
							2,194.6
PV	-143.1	-54.2	-14.2	4.7	3.2	20.0	2,222.6
Total discounted FCFF	2,039.0						
Deduct borrowings	110.0						
Equity	1,929.0						
Value/share	1.10						
Tax rate	25%						
WACC	4.8%						
Cost of equity	7.5%						
Cost of debt	3.5%						
% equity	45%						
% debt	55%						
Terminal growth	3.5%						

Source: RHB

**Bear case scenario**

In our bear-case scenario (Figures 5 and 6), we assume high staff costs that Raffles Medical would incur if it is not able to bring up its beds' occupancy rate. We estimate that Chongqing hospital would be worth SGD0.37 per share using a 10-year DCF, if take-up rate is slow and Raffles Medical is unable to control its fixed cost.

◆ If Chongqing fails, the long-term DCF still yields a value of SGD0.37 per share. However, Raffles Medical would be burning more cash in the first five years to turn things around.

**Figure 5: Revenue assumption in bear case**

	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	Comment
Licensed beds	700	700	700	700	700	700	700	700	700	
Beds to commence in phases	200	200	200	200	300	300	300	300	300	Excludes 100 beds used for public healthcare. In the bear case, demand does not require the use of 700 beds.
Occupancy rate	10%	40%	60%	75%	55%	60%	65%	70%	75%	Slower take-up rate
Number of inpatient visits	507	4,867	7,300	9,125	10,038	10,950	11,863	12,775	13,688	
Average spending per inpatient visit (CNY)	22,420	22,420	23,093	23,785	24,499	25,234	25,991	26,771	27,574	
Number of outpatient visits	5,069	48,667	73,000	91,250	100,375	109,500	118,625	127,750	136,875	Using ratio of 10 outpatients to 1 inpatient based on the Singapore public hospital ratio, provided by Ministry of Health data
Average spending per outpatient visit (CNY)	400	412	424	437	450	464	478	492	507	
Revenue (CNYm)	13.4	129.2	199.6	256.9	291.1	327.1	365.0	404.8	446.8	
EBIT (CNYm)	-93.2	-84.0	-43.3	6.2	0.4	13.0	32.5	52.4	73.4	Higher fixed cost
EBIT margin	-695.8%	-65.0%	-21.7%	2.4%	0.1%	4.0%	8.9%	12.9%	16.4%	
SGD/CNY	4.94									
EBIT (SGDm)	-18.9	-16.8	-8.7	1.2	0.1	2.6	6.5	10.5	14.7	

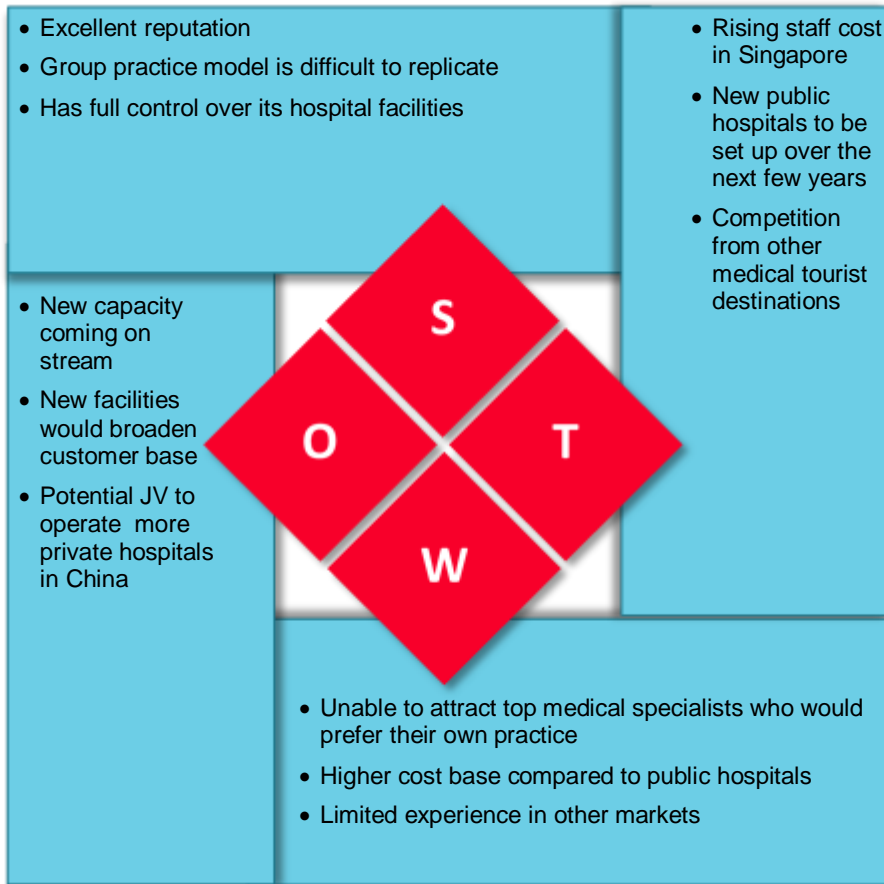
Source: RHB

**Figure 6: DCF assumptions in bear case**

	FY17F	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F
EBIT*(1-tax)	0.0	-14.2	-12.6	-6.5	0.9	0.1	2.0	4.9	7.9	11.0
Capex	-150.0	-52.5	-15.0	-10.0	-15.0	-5.0	-5.0	-5.0	-5.0	-5.0
Dep & Amort		5.0	5.5	5.8	6.0	6.2	6.4	6.4	6.4	6.4
Net change in working capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCFF	-150.0	-61.7	-22.1	-10.7	-8.1	1.3	3.4	6.3	9.3	12.4
										973.8
PV	-143.1	-61.7	-22.1	-10.7	-8.1	1.3	3.4	6.3	9.3	986.2
Total discounted FCFF	760.7									
Deduct borrowings	110.0									
Equity	650.7									
Value/share	0.37									
Tax rate	25%									
WACC	4.8%									
Cost of equity	7.5%									
Cost of debt	3.5%									
% equity	45%									
% debt	55%									
Terminal growth	3.5%									

Source: RHB

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2015-07-01	Buy	1.87	1.52
2015-05-15	Buy	1.57	1.41
2015-04-28	Buy	1.57	1.33

Source: RHB, Bloomberg

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**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

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