

1 August 2017

Consumer Non-cyclical | Healthcare

Raffles Medical Group

Sell (from Neutral)

Bear For a Couple More Years

Target Price: SGD1.10
 Price: SGD1.28
 Market Cap: USD1,661m
 Bloomberg Ticker: RFMD SP

Post analyst briefing, we understand from management that its hospitals in China would likely take three years to reach a positive EBITDA. We now turn bearish on Raffles Medical as near-term growth is mainly supported by rental income instead of organic growth; therefore we think there is a lack of an upside catalyst in the near term. Downgrade to SELL with a DCF-derived TP SGD1.10 (from SGD1.49) implying 14% downside.

Share Data

Avg Daily Turnover (SGD/USD) 2.19m/1.58m
 52-wk Price low/high (SGD) 1.27 - 1.58
 Free Float (%) 48
 Shares outstanding (m) 565
 Estimated Return -14%

Near term growth supported by rental income rather than organic growth.

We believe the current valuation for Raffles Medical is high given that the Singapore healthcare scene continues to face slowdown in demand. Holland V medical centre was fully let out by 2Q17. Yet, despite a rental income booster from Holland V, revenue from healthcare services still fell by 1.1% in 2Q, implying a stronger decline in core revenue.

Shareholders (%)

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

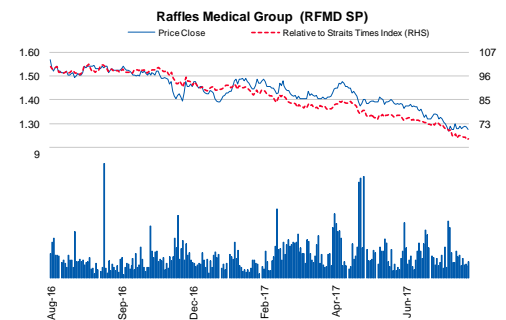
On the hospital services side, revenue grew marginally at 0.3% in 2Q. However, management cited that some of the foreign patients who came for diagnosis could not afford the treatment, leading to a single digit percentage decline in inpatient numbers. We think there might be a structural decline in inpatient load moving forward if the economic outlook in the region remains weak. Henceforth, while we expect an uplift in FY18F revenue driven by the hospital extension (open in 4Q17), we think most of it is still coming from rental income as 50% of the new space would be let out.

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(10.8)	(4.1)	(8.9)	(13.3)	(19.1)
Relative	(26.4)	(7.7)	(13.8)	(22.0)	(33.2)

Source: Bloomberg

Bear for a couple more years before China delivers. Chongqing hospital and Shanghai hospital would probably begin their operations in 2H18F and 2H19F respectively. Management cited that a typical Chinese hospital would need three years to reach a positive EBITDA but losses should not wipe out 30-40% of the group's profit. Previously, we had used the average operational cost of existing listed Chinese hospitals as a gauge for Raffles Medical potential start-up expenses. Given the new guidance from management, we think the "blue sky" scenario presented in our previous report from 25 April is too optimistic: [Raffles Medical Group : Near-Term Headwinds](#).



Source: Bloomberg

Change in forecast as we now project each hospital in China to generate an operating loss of about SGD10m and SGD14m for its first two years of operations. We now incorporated the estimated results from the Chinese hospitals into our model. Together with a slower growth in domestic healthcare demand, we reduced our FY17-19F PATMI by 4%, 22% and 26% respectively.

Downgrade to SELL with a DCF-derived TP SGD1.10 (from SGD1.49). We downgrade as we think that the current valuation of 32x FY18F P/E is too high given that:

- Near-term earnings support is coming from non-core rental income;
- Domestic healthcare demand is likely to see structural decline;
- Start-up costs from the Chinese hospitals venture are going to be a drag especially in the first two years.

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (SGDm)	411	474	477	503	562
Reported net profit (SGDm)	69.3	70.2	72.6	69.7	75.5
Recurring net profit (SGDm)	67.8	68.7	72.6	69.7	75.5
Recurring net profit growth (%)	5.0	1.2	5.7	(4.0)	8.3
Recurring EPS (SGD)	0.12	0.04	0.04	0.04	0.04
DPS (SGD)	0.06	0.02	0.02	0.02	0.02
Recurring P/E (x)	10.7	32.4	30.7	31.9	29.5
P/B (x)	1.22	3.34	3.16	3.01	2.86
P/CF (x)	9.8	27.5	22.1	22.4	21.1
Dividend Yield (%)	4.7	1.6	1.6	1.6	1.6
EV/EBITDA (x)	3.8	18.5	17.3	17.1	15.6
Return on average equity (%)	12.1	11.1	10.6	9.7	9.9
Net debt to equity (%)	net cash	net cash	net cash	0.2	net cash
Our vs consensus EPS (adjusted) (%)			1.3	(7.2)	(9.9)

Source: Company data, RHB

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Financial Exhibits

Financial model updated on : 2017-07-31.

Asia		Financial summary	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Singapore		Recurring EPS (SGD)	0.12	0.04	0.04	0.04	0.04
Consumer Non-cyclical		EPS (SGD)	0.12	0.04	0.04	0.04	0.04
Raffles Medical Group		DPS (SGD)	0.06	0.02	0.02	0.02	0.02
Bloomberg	RFMD SP	BVPS (SGD)	1.05	0.38	0.40	0.42	0.45
Sell		Weighted avg adjusted shares (m)	570	1,747	1,747	1,747	1,747
Valuation basis		Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
DCF		Recurring P/E (x)	10.7	32.4	30.7	31.9	29.5
		P/E (x)	10.5	31.7	30.7	31.9	29.5
		P/B (x)	1.22	3.34	3.16	3.01	2.86
		FCF Yield (%)	5.4	3.0	3.6	3.6	3.8
		Dividend Yield (%)	4.7	1.6	1.6	1.6	1.6
		EV/EBITDA (x)	3.8	18.5	17.3	17.1	15.6
		EV/EBIT (x)	4.4	21.8	20.3	20.2	18.3
Key drivers							
i. Weak economic outlook in the region							
ii. Depreciation of regional currencies against Singapore							
iii. Slow ramp up phase for Chinese hospitals							
Key risks							
Shorter than expected gestation periods							
Company Profile							
Raffles Medical Group Ltd owns and operates medical clinics in Singapore. The company operates through three segments: Healthcare Services, Hospital Services, and 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.							
Income statement (SGDm)		Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F	
Total turnover		411	474	477	503	562	
Gross profit		329	382	388	412	465	
EBITDA		93	97	101	99	105	
Depreciation and amortisation		(13)	(15)	(15)	(15)	(16)	
Operating profit		81	82	86	84	90	
Net interest		1	1	0	(0)	(1)	
Pre-tax profit		82	83	86	84	89	
Taxation		(13)	(15)	(15)	(15)	(16)	
Minority interests		0	2	2	1	3	
Recurring net profit		68	69	73	70	76	
Cash flow (SGDm)		Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F	
Change in working capital		(10)	(5)	18	15	17	
Cash flow from operations		74	81	101	100	106	
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	71	53	
Net change in cash		(77)	28	(41)	(18)	23	
Ending balance cash		74	114	71	53	77	
Balance sheet (SGDm)		Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F	
Total cash and equivalents		86	112	71	53	77	
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	949	1,002	1,087	
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	229	248	292	
Shareholders' equity		603	666	704	739	779	
Minority interests		19	15	15	15	15	
Total equity		622	682	719	754	795	
Net debt		(54)	(81)	(16)	2	(2)	
Total liabilities & equity		815	901	949	1,002	1,087	
Key metrics		Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F	
Revenue growth (%)		9.6	15.4	0.8	5.4	11.8	
Recurrent EPS growth (%)		3.0	(67.0)	5.7	(4.0)	8.3	
Gross margin (%)		80.2	80.6	81.2	82.0	82.6	
Operating EBITDA margin (%)		22.8	20.4	21.1	19.7	18.7	
Net profit margin (%)		16.9	14.8	15.2	13.9	13.4	
Dividend payout ratio (%)		49.8	49.8	48.1	50.1	46.3	
Capex/sales (%)		8.4	3.1	4.2	4.0	3.6	
Interest cover (x)		(80.4)	(83.3)	(252.2)	839.0	179.1	

Source: Company data, RHB

Figure 1: 2Q17 results summary

FYE Dec (SGD m)	2Q17	1Q17	QoQ (%)	2Q16	YoY (%)	Comments
Revenue	120.1	114.9	4.5	119.0	1.0	Hospital services grew by 0.3% YoY while healthcare services declined by 1.1% YoY.
Staff costs	61.9	61.0	1.5	59.9	3.3	Staff cost as a percentage of revenue fell QoQ as a result of better cost control in MCH.
% of revenue	51.5	53.1		50.4		
EBIT	19.6	18.1	8.2	20.0	(1.9)	
<i>EBIT Margin (%)</i>	16.3	15.7		16.8		
Pretax profit	19.8	18.3	8.4	20.3	(2.3)	
<i>Pretax Margin (%)</i>	16.5	15.9		17.0		
Net Profit attributable	16.8	15.5	7.8	16.7	0.5	
<i>Net Margin (%)</i>	13.5	13.0		13.6		

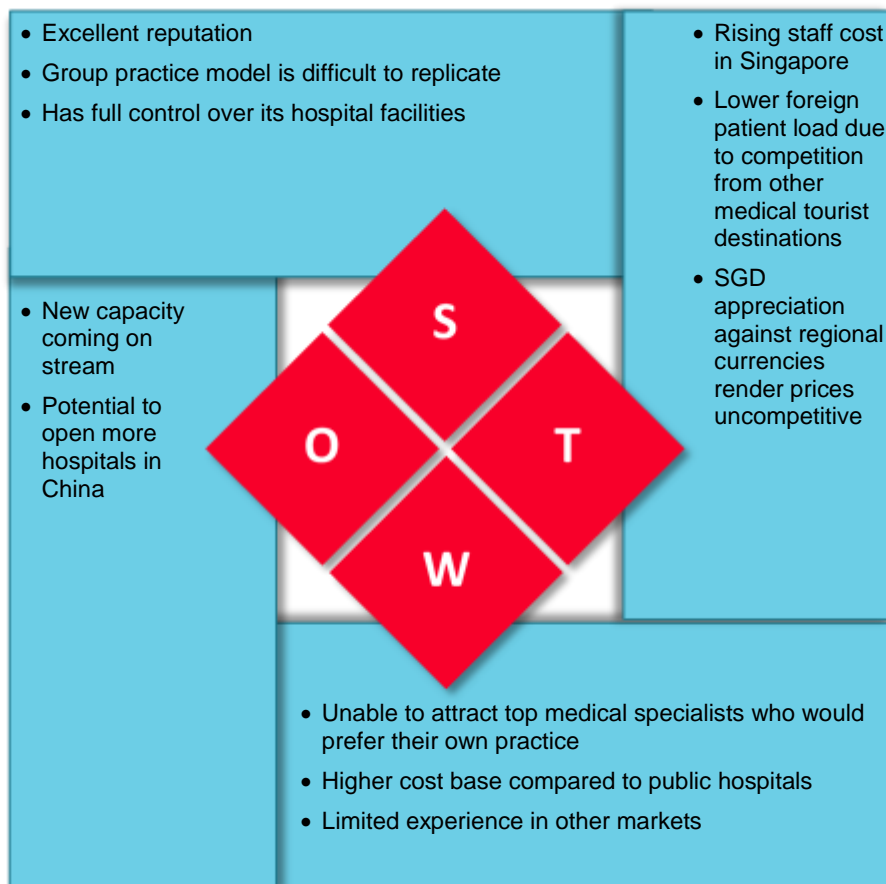
Source: Company, RHB

Figure 2: DCF assumptions

SGD m	FY17F	FY18F	FY19F	FY20F	FY21F	FY22F
Net income	72.6	69.7	75.5	82.3	90.6	101.4
+ 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	17.6	15.4	17.0	5.0	5.0	5.0
+ Change in debt	24.6	0.0	20.0	(40.0)	(40.0)	(5.0)
FCFE	(3.2)	17.2	58.2	35.3	55.6	101.4
Terminal Value						2,657.5
PV	(3.0)	14.9	46.9	26.5	38.8	1,792.7
Total discounted FCFE	1,916.8					
Value/ Share (SGD)	1.10					
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
2017-04-25	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
2015-07-01	Buy	1.87	1.52
2015-05-15	Buy	1.57	1.41

Source: RHB, Bloomberg

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