Raffles Medical RFMD SP

HEALTH CARE & PHARMACEUTICALS | SINGAPORE

Jit Soon Lim, CFA +65 6433 6969 jitsoon.lim@nomura.com
Yuan Yiu Tsai +65 6433 6964 yuanyiu.tsai@nomura.com

Maintained

BUY

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Action

Raffles Medical (RMG) posted a good set of 3Q09 results, with 16% y-y net profit growth, in line with our forecasts. The key highlight is continued growth of its foreign patient load, bucking the trend seen at its peers. We believe the group is well-positioned to tap into a potential recovery in demand from both local and foreign patients going into FY10F. We maintain BUY and raise our PT to S$1.58.

Catalysts

The key near-term catalysts include: 1) potential capital management (net cash of S$35mn as of 3Q09), and 2) growth in local patients, which has seen a slight decline in 9M09, along with the economic recovery in FY10F.

Anchor themes

We believe continued demand for private healthcare in the region will support long-term prospects for Singapore healthcare service operators, which enjoy strong operating margins, brand equity and high entry barriers.

Closing price on 4 Nov	S$1.33
Price target	**S$1.58**
	(from S$1.30)
Upside/downside	18.8%
Difference from consensus	**5.3%**
FY10F net profit (S$mn)	44.80
Difference from consensus	**25.3%**

Source: Nomura

Nomura vs consensus

Our revenue forecasts are in line, but earnings estimates are ahead of the street, owing to our recognition of the significant operating leverage.

Steady growth (III)

① Growing amid the recession

Despite the recession, the group delivered 8% top-line growth in 3Q09, with 9.3% growth in healthcare services and 8.1% growth at its flagship hospital. Driven by operating leverage and partly supported by jobs credit, its net profit showed consistent 15.6% y-y growth, in line with our forecast.

② Continued growth in foreign patients

In our view, the key highlight of RMG's 9M09 performance is consistent growth in foreign patient volume. According to management, the number of foreign patients increased by 9% y-y in 3Q09, with Indonesian and Russian patients making up 22% and 7% of the total foreign patient load, respectively. Compared with Parkway's 4-8% decline in foreign patients in 1H09, we think this growth is remarkable and believe that RMG is well-positioned to tap into a potential recovery in regional demand going into FY10F.

③ Operating leverage will drive EPS growth in recovery

We forecast 12-14% revenue growth in FY10-11F on the back of a potential increase in local demand along with the recovery in the economy, as well as continued growth in foreign patients. We estimate 20-24% EPS growth for the next two years, driven by the significant operating leverage arising from the high fixed-cost base (50% of operating costs, in our estimate).

④ Raising price target to $1.58, suggesting 19% upside

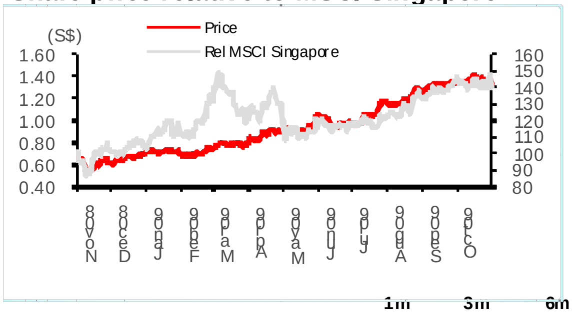
Our new PT of $1.58 is based on 18x FY10E P/E (from 16.4x), in line with regional peers. We reiterate our view that RMG has a strong healthcare franchise in Singapore, with potential to expand into the region. We maintain our BUY rating.

Key financials & valuations

31 Dec (S$mn)	FY08	FY09F	FY10F	FY11F
Revenue	200.8	216.9	247.8	277.6
Reported net profit	31.3	36.0	44.8	53.9
Normalised net profit	31.3	36.0	44.8	53.9
Normalised EPS (S$)	0.060	0.067	0.084	0.101
Norm. EPS growth (%)	26.8	12.9	24.4	20.4
Norm. P/E (x)	22.3	19.7	15.8	13.2
EV/EBITDA (x)	14.9	13.0	10.2	8.1
Price/book (x)	3.1	2.8	2.5	2.2
Dividend yield (%)	1.9	2.3	2.3	2.6
ROE (%)	14.8	15.5	17.4	18.6
Net debt/equity (%)	net cash	net cash	net cash	net cash
Earnings revisions				
Previous norm. net profit		35.7	42.4	52.1
Change from previous (%)		0.8	5.6	3.5
Previous norm. EPS (S$)		0.067	0.079	0.098

Source: Company, Nomura estimates

Share price relative to MSCI Singapore



	1m	3m	6m
Absolute (S$)	(1.5)	13.7	47.8
Absolute (US$)	(0.2)	16.6	56.7
Relative to Index	(2.9)	14.8	20.7
Market cap (US$mn)			494.4
Estimated free float (%)			49.4
52-week range (S$)			1.42/0.55
3-mth avg daily turnover (US$mn)			0.30
Stock borrowability			Hard
Major shareholders (%)			
Loo Choon Yong			40.2
Temasek Holdings			4.9

Source: Company, Nomura estimates

Any authors named on this report are research analysts unless otherwise indicated. See the important disclosures and analyst certifications on pages 6 to 9.

Exhibit 1. Raffles Medical: 3Q09 results

(S$mn)	3Q08	2Q09	3Q09	Y-y% chg	Q-q% chg	Remarks
Revenue	51.3	53.9	55.4	8.0	2.8	Healthcare services: +9.3% y-y, Hospital services: +8.1% y-y
EBIT	10.2	11.0	11.9	16.3	8.3	9M09 EBIT margin: 23.4% (vs. 2008: 22.5%)
Net profit	8.2	8.8	9.5	15.6	7.4	
Diluted EPS (S$)	1.57	1.68	1.80	14.6	7.1	

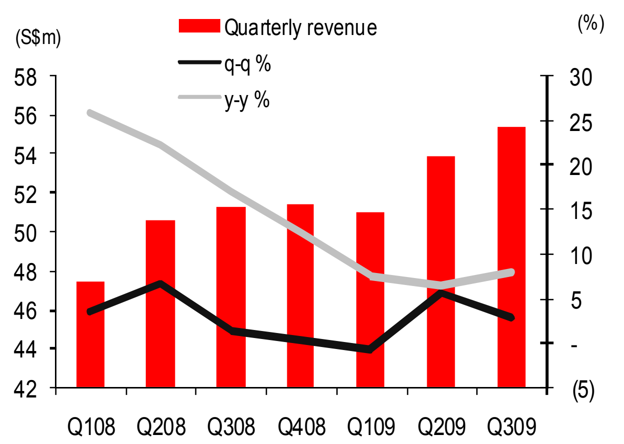
Source: Company data, Nomura research

Valuation methodology

We value RMG based on a target P/E of 18x on FY10F earnings, in line with regional peers, deriving a core valuation of S$1.51/share. Our price target of S$1.58 is derived after adding an estimated net cash/share of S$0.07. We believe an earnings-based methodology reflects its strong growth profile — both organic growth in Singapore and its potential to expand into the region owing to a strong healthcare franchise.

The risks to our price target are: 1) an ability to attract and retain medical professionals; and 2) regulatory risks in Singapore.

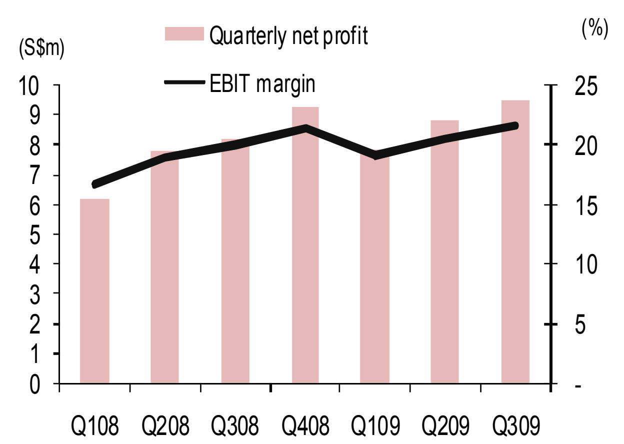
Exhibit 2. Quarterly revenue trend



Source: Company data

Healthy quarterly revenue growth trend amid the recession

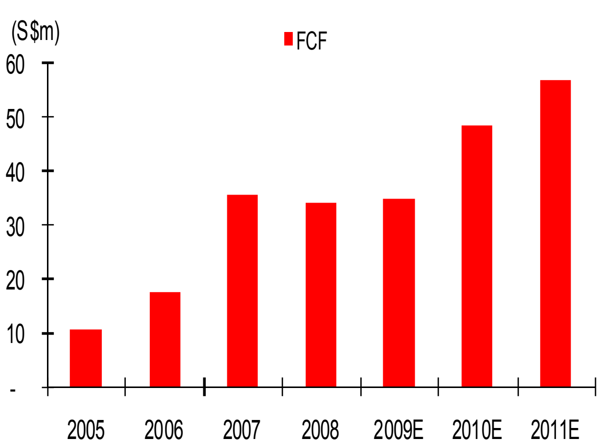
Exhibit 3. Quarterly net profit trend



Source: Company data

Uptrend in margins is driven by significant operating leverage

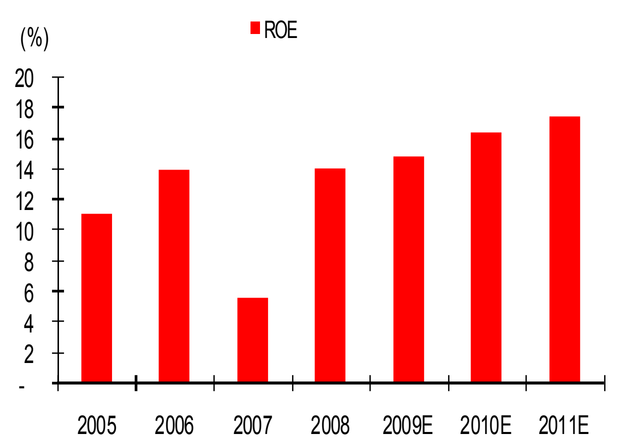
Exhibit 4. FCF trend



Source: Company data, Nomura estimates

With low capex, positive working capital and strong margins, RMG generates significant FCF (a FY10F FCF yield of 6.8%)

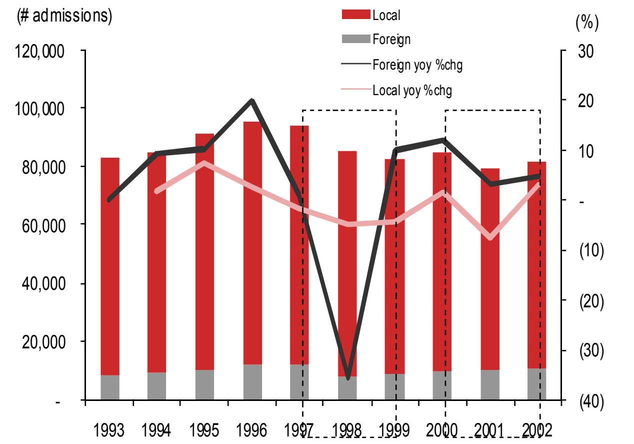
Exhibit 5. ROE



Source: Company data, Nomura estimates

RMG exhibits a strong ROE of 15-18% over FY09-11F

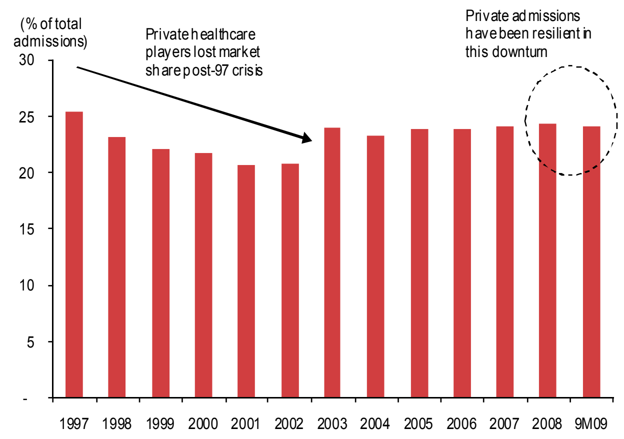
Exhibit 6. Admissions trend during past crisis



Source: Ministry of Health

Private admissions has been flat in 9M09 (vs -9% in 1998 and -6% in 2001), suggesting resilience of the sector

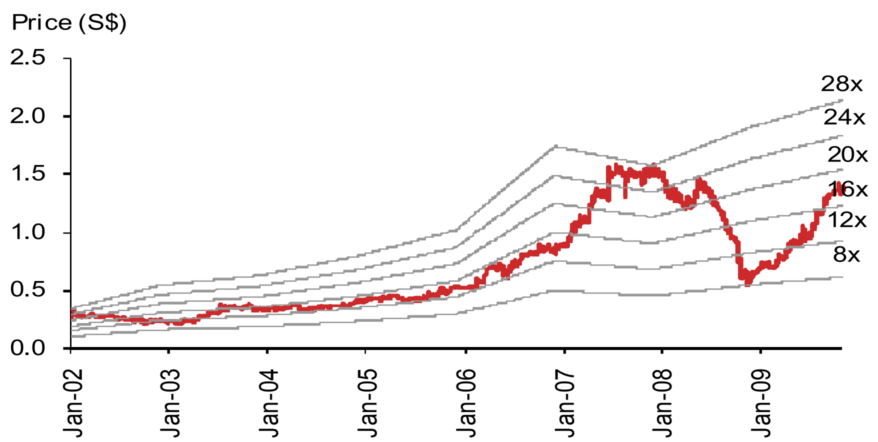
Exhibit 7. Private admissions market share



Source: Ministry of Health

9M09 private admissions' market share has been stable at 24%

Exhibit 8. RMG: 12-month forward P/E



Source: Bloomberg, Nomura estimates

Financial statements

Income statement (S$mn)					
Year-end 31 Dec	FY07	FY08	FY09F	FY10F	FY11F
Revenue	168.7	200.8	216.9	247.8	277.6
Cost of goods sold	(140.4)	(162.3)	(173.3)	(193.9)	(213.1)
Gross profit	**28.2**	**38.5**	**43.6**	**54.0**	**64.6**
SG&A	-	-	-	-	-
Employee share expense	-	-	-	-	-
Operating profit	**28.2**	**38.5**	**43.6**	**54.0**	**64.6**
EBITDA	**32.4**	**45.1**	**50.5**	**60.9**	**71.6**
Depreciation	(4.2)	(6.6)	(6.8)	(7.0)	(7.1)
Amortisation	-	-	-	-	-
EBIT	**28.2**	**38.5**	**43.6**	**54.0**	**64.6**
Net interest expense	(0.4)	(0.4)	(0.1)	0.2	0.6
Associates & JCEs	1.1	-	-	-	-
Other income	-	-	-	-	-
Earnings before tax	**28.9**	**38.1**	**43.5**	**54.1**	**65.2**
Income tax	(5.5)	(6.7)	(7.4)	(9.2)	(11.1)
Net profit after tax	**23.4**	**31.4**	**36.1**	**44.9**	**54.1**
Minority interests	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
Other items	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	**23.4**	**31.3**	**36.0**	**44.8**	**53.9**
Extraordinary items	12.5	-	-	-	-
Reported NPAT	**35.9**	**31.3**	**36.0**	**44.8**	**53.9**
Dividends	(17.8)	(12.9)	(15.5)	(15.5)	(17.6)
Transfer to reserves	**18.1**	**18.4**	**20.5**	**29.3**	**36.3**
Valuation and ratio analysis					
FD normalised P/E (x)	28.2	22.3	19.7	15.8	13.2
FD normalised P/E at price target (x)	33.5	26.4	23.4	18.8	15.6
Reported P/E (x)	18.4	22.3	19.7	15.8	13.2
Dividend yield (%)	2.7	1.9	2.3	2.3	2.6
Price/cashflow (x)	16.5	17.4	18.3	13.3	11.4
Price/book (x)	3.2	3.1	2.8	2.5	2.2
EV/EBITDA (x)	20.8	14.9	13.0	10.2	8.1
EV/EBIT (x)	23.8	17.5	15.0	11.5	9.0
Gross margin (%)	16.7	19.2	20.1	21.8	23.3
EBITDA margin (%)	19.2	22.5	23.3	24.6	25.8
EBIT margin (%)	16.7	19.2	20.1	21.8	23.3
Net margin (%)	21.3	15.6	16.6	18.1	19.4
Effective tax rate (%)	19.0	17.6	17.0	17.0	17.0
Dividend payout (%)	49.5	41.3	43.1	34.7	32.6
Capex to sales (%)	2.5	3.1	1.8	2.0	2.0
Capex to depreciation (x)	1.0	0.9	0.6	0.7	0.8
ROE (%)	na	14.8	15.5	17.4	18.6
ROA (pretax %)	na	14.6	16.4	20.2	24.0
Growth (%)					
Revenue		19.0	8.0	14.3	12.0
EBITDA		39.0	11.9	20.8	17.6
EBIT		36.4	13.4	23.7	19.6
Normalised EPS		26.8	12.9	24.4	20.4
Normalised FDEPS		26.8	12.9	24.4	20.4
Per share					
Reported EPS (S$)	0.07	0.06	0.07	0.08	0.10
Norm EPS (S$)	0.05	0.06	0.07	0.08	0.10
Fully diluted norm EPS (S$)	0.05	0.06	0.07	0.08	0.10
Book value per share (S$)	0.41	0.43	0.47	0.52	0.59
DPS (S$)	0.04	0.03	0.03	0.03	0.03

Source: Nomura estimates

Expansion in margins due to operating leverage

Cashflow (S$mn)					
Year-end 31 Dec	**FY07**	**FY08**	**FY09F**	**FY10F**	**FY11F**
EBITDA	32.4	45.1	50.5	60.9	71.6
Change in working capital	13.3	1.0	(4.2)	1.5	1.2
Other operating cashflow	(5.7)	(6.0)	(7.5)	(9.0)	(10.5)
Cashflow from operations	**40.1**	**40.1**	**38.8**	**53.4**	**62.4**
Capital expenditure	(4.3)	(6.1)	(4.0)	(5.0)	(5.5)
Free cashflow	**35.8**	**33.9**	**34.8**	**48.4**	**56.9**
Reduction in investments	14.3	0.7	-	-	-
Net acquisitions					
Reduction in other LT assets		0.1	-	-	-
Addition in other LT liabilities		0.0	-	-	-
Adjustments	(62.8)	1.2	-	-	-
Cashflow after investing acts	**(12.8)**	**36.0**	**34.8**	**48.4**	**56.9**
Cash dividends	(17.8)	(12.9)	(15.5)	(15.5)	(17.6)
Equity issue	69.0	1.3	(0.1)	-	-
Debt issue	(60.4)	0.9	(6.5)	(4.4)	(4.4)
Convertible debt issue	-	-	-	-	-
Others	-	-	-	-	-
Cashflow from financial acts	**(9.2)**	**(10.7)**	**(22.1)**	**(19.9)**	**(22.0)**
Net cashflow	**(22.0)**	**25.2**	**12.7**	**28.4**	**34.9**
Beginning cash	41.3	19.7	44.5	57.2	85.6
Ending cash	19.3	45.0	57.2	85.6	120.5
Ending net debt		(17.9)	(37.1)	(69.9)	(109.2)

Source: Nomura estimates

Significant FCF owing to low capex, and positive working capital

Balance sheet (S$mn)					
As at 31 Dec	**FY07**	**FY08**	**FY09F**	**FY10F**	**FY11F**
Cash & equivalents	19.7	44.5	57.2	85.6	120.5
Marketable securities	0.7	-	-	-	-
Accounts receivable	20.2	24.9	27.1	31.0	34.7
Inventories	3.8	4.8	4.9	5.6	6.3
Other current assets	0.7	-	-	-	-
Total current assets	**45.2**	**74.2**	**89.2**	**122.2**	**161.5**
LT investments	84.4	84.4	84.4	84.4	84.4
Fixed assets	150.8	150.3	147.4	145.5	143.9
Goodwill	-	-	-	-	-
Other intangible assets	0.3	0.3	0.3	0.3	0.3
Other LT assets	1.5	1.3	1.3	1.3	1.3
Total assets	**282.2**	**310.4**	**322.6**	**353.7**	**391.4**
Short-term debt	25.3	4.6	2.5	2.5	2.5
Accounts payable	48.2	51.5	49.7	55.7	61.3
Other current liabilities	6.7	9.3	9.3	9.3	9.3
Total current liabilities	**80.2**	**65.4**	**61.5**	**67.5**	**73.1**
Long-term debt	-	22.0	17.6	13.2	8.8
Convertible debt	-	-	-	-	-
Other LT liabilities	0.7	0.7	0.7	0.7	0.7
Total liabilities	**80.9**	**88.2**	**79.8**	**81.5**	**82.7**
Minority interest	0.2	0.3	0.4	0.6	0.7
Preferred stock	-	-	-	-	-
Common stock	170.0	171.3	171.3	171.3	171.3
Retained earnings	30.8	50.6	71.1	100.3	136.7
Proposed dividends	-	-	-	-	-
Other equity and reserves	-	-	-	-	-
Total shareholders' equity	**200.8**	**221.9**	**242.3**	**271.6**	**308.0**
Total equity & liabilities	**282.0**	**310.4**	**322.6**	**353.7**	**391.4**
Liquidity (x)					
Current ratio	0.56	1.13	1.45	1.81	2.21
Interest cover	75.0	105.4	454.1	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable		41.1	43.8	42.8	43.2
Days inventory		9.6	10.2	9.9	10.2
Days payable		112.4	106.6	99.3	100.3
Cash cycle	-	(61.7)	(52.7)	(46.6)	(46.9)

Source: Nomura estimates

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Raffles Medical	RFMD SP			Buy	

Previous Ratings

Issuer	Previous Rating	Date of change
Raffles Medical	No Rating	03 Mar 2009

Three-year stock price and rating history

Not Available for Raffles Medical

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As at 30 September 2009.

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A "**Neutral**" stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.
A "**Bearish**" stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.
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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008:

Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

• A "**Strong buy**" recommendation indicates that upside is more than 20%.
• A "**Buy**" recommendation indicates that upside is between 10% and 20%.
• A "**Neutral**" recommendation indicates that upside or downside is less than 10%.
• A "**Reduce**" recommendation indicates that downside is between 10% and 20%.
• A "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

A "**Bullish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A "**Neutral**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Price targets

Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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Nomura Singapore Limited Tel: +65 6433 6288
5 Temasek Boulevard #11-01, Suntec Tower Five,
Singapore 038985, Singapore Fax: + 65 6433 6169

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