

Raffles Medical Group

Steady 3Q

- Raffles Medical reported 3Q results with revenue growth of 13% YoY and net profit growth of 10% YoY.
- We reiterate our Outperform rating with a price target of SGD2.81 (previously SGD2.83) per share, which offers 25% upside.
- The results are within our expectations but we revise down our 2011E and 2012E EPS by 4% and 5%, respectively, to account for start up costs for the Shanghai clinics and a later opening for the Thong Sia specialist centre.
- We continue to like Raffles Medical for its steady growth, vertical integration and unique business model.
- Raffles Medical is trading at PER 21x 2012E with a 1.9% yield.

No surprises in results. Raffles Medical continued its steady growth in 3Q with hospital segment revenue growing 14% YoY and healthcare services (primary care) growing 8% YoY. Net profit grew below top-line at 10% YoY as the group's clinics in Shanghai are loss-making and Raffles hired more doctors ahead of its expansion.

Thong Sia and Raffles Hospital future drivers. Management expects the specialist medical centre at Bideford Road (Thong Sia) to start operations in the first half of 2013 (our original expectation was 2012). The expansion of Raffles Hospital by 102,408 sq ft is still in the planning phase and management believes it should be completed by 2H 2014 (original expectation was 2013). As a result, we lower our growth expectation of hospital segment revenue to 13% YoY for 2012E (from 17%).

Valuations reasonable for strong and steady cash flow. Our preferred method for valuing Raffles Medical is a DCF-model as it captures the steady growth and strong cash flow nature of the business. However, we recognize that the market often values stocks on shorter-term PER based multiples. As a result, we have used a blend of PER-based (PER 19x 2012E) and DCF-based valuation (translates to PER 33x 2012E). Our price target translates to PER 26x 2012E.

OUTPERFORM (unchanged)

PRICE as at 31 October 2011 **PRICE TARGET**
S\$2.25 **S\$2.81**

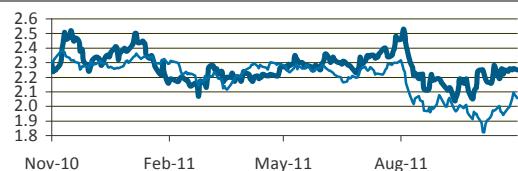
Bloomberg code RFMD SP **Reuters code** RAFG.SI
Market cap S\$1,201m (US\$958m) **12 month range** S\$2.04 - 2.53

EPS adj est change 2011E -3.6% 2012E -5.0%

Year end: December	2010	2011E	2012E	2013E
Sales (S\$m)	239	269	299	336
EBITDA (S\$m)	60	66	80	91
EBIT (S\$m)	53	59	68	78
Pretax profit (S\$m)	53	59	68	78
Net profit adjusted (S\$m)	45	50	58	66
FCF (S\$m)	44	(61)	24	45
EPS adjusted (S\$)	0.09	0.09	0.11	0.12
DPS (S\$)	0.00	0.00	0.00	0.00
Book value/share (S\$)	0.54	0.59	0.66	0.73
EPS growth adj (%)	17.8	10.4	14.6	14.8
DPS growth (%)	22.2	-30.9	13.7	14.8
EBITDA margin (%)	25.1	24.7	26.7	27.3
EBIT margin (%)	22.2	22.1	22.8	23.2
Net margin adj (%)	18.9	18.7	19.3	19.7
Div payout (%)	0.6	0.4	0.4	0.4
Net gearing (%)	-29.5	-1.2	-1.4	-6.0
ROE (%)	16.9	16.7	17.3	17.9
ROCE (%)	18.3	18.4	19.2	19.9
EV/Sales (x)	3.8	4.4	4.0	3.5
EV/EBITDA (x)	15.3	17.9	15.0	12.9
PBR (x)	4.4	3.8	3.4	3.1
PER adj (x)	22.0	23.9	20.9	18.2
Dividend yield (%)	0.0	0.0	0.0	0.0

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	0	-9	3
Relative to Index	-6	2	14
Relative to Sector	-	-	-
Major shareholder	Raffles Medical Holdings (39.2%)		
Free float	42%		
Average turnover (US\$)	579,091		

Source: Company, Bloomberg

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Important disclosures can be found in the Disclosures Appendix

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3Q 2011 results review

Continued delivery

Results within our expectations

Raffles Medical reported 3Q 2011 results with revenue growth of 13% YoY and net profit growth of 10% YoY. Key points:

- **Steady growth.** Hospital segment revenue grew 14% YoY while healthcare services (GP) grew 8% YoY. Hospital segment revenue continued its robust double-digit growth, but healthcare segment revenue growth showed a deceleration.

Fig 1: Segmental revenues

	1Q 11A	2Q 11A	3Q 11A
Hospital	15.0%	14.5%	14.1%
Healthcare	14.4%	12.2%	8.4%

Source: Company, Standard Chartered Research estimates

- **Shanghai clinics hurting margins.** 3Q net profit grew 10% YoY compared to revenue growth of 13% YoY as Raffles Medical's clinics in Shanghai are losing money. We estimate the Shanghai clinics may have lost SGD0.5m in 3Q.
- **Within our expectations.** 9m2011 earnings represent 65% of our full-year estimate. We note that 4Q is traditionally a strong quarter for Raffles Medical and 9m2010 was 66% of full-year 2010 profit.
- **Strong balance sheet and cash flow.** Raffles Medical maintained net cash of SGD9m at end-3Q even after the acquisition of Thong Sia building. Operating cash flow for 9m2011 grew 33% YoY to SGD44m while capex only grew 15% YoY.

Tweak our estimates

Conservatively tweak our estimates

We tweak our 2011E and 2012E EPS estimates by 4% and 5%, respectively. For 2011, we model slightly lower margins due to the start up costs of the Shanghai clinics and for 2012 we model lower hospital segment growth as Thong Sia contribution may only start in 2013.

Fig 2: Old versus new estimates

Year end: Dec	Old estimates		New estimates		Variance	
	2011E	2012E	2011E	2012E	2011E	2012E
Revenue (SGDm)	272	311	269	299	-1.2%	-4.0%
Net profit (SGDm)	52	61	50	58	-3.6%	-5.0%
EPS (SGD cents)	9.75	11.34	9.40	10.77	-3.6%	-5.0%

Source: Standard Chartered Research estimates



Valuation

Blended valuation

Blended approach results in price target of SGD2.81 per share (PER 27x 2012E)

We use a blended approach to value Raffles Medical to account for both a shorter-term relative valuation (PER based) and longer-term absolute valuation (DCF). Our preferred valuation method for Raffles Medical is a DCF model as it captures the company's steady growth and strong cash flows. However, our DCF model translates to a PER of 33x and we believe the market may struggle to ascribe such a value to the stock near-term. As a result, we assign a 50% weighting to each approach for a blended price target of SGD2.81 per share, which translates to PER 27x 2012E.

Fig 3: Blended valuation summary

	Price target (SGD)	Target multiple (PER x)
PER based valuation	2.05	19
DCF based valuation	3.58	33
Final valuation	2.81	26

Source: Standard Chartered Research estimates

Relative valuation

PER 19x for relative valuation in line with Bumrungrad

We believe Raffles Medical's closest comparable is Bumrungrad as they generate similar ROCEs, have similar growth, and both are leading healthcare providers in Asia. As a result, our PER based target multiple for Raffles Medical is 19x 2012E, in line with Bumrungrad.

Fig 4: Peer comparison

Name	Rating	Target price (LCY)	Price (LCY)	Market cap (USDm)	3M avg value traded (USDm)	Last FYE	PER (x)			2 year EPS CAGR	PEG	EV/EBITDA (x)		Div. Yield %	Last Reported ROCE (%)
							FY10	FY11E	FY12E			FY10	FY11E		
RAFFLES MEDICAL	OP	2.81	2.25	962	0.59	12/10	26.4	23.9	20.9	12.5	1.8	17.5	15.3	1.8	17.1
HEALTHWAY MEDIC	IL	0.17	0.09	146	0.19	12/10	53.4	21.6	17.5	74.4	0.3	32.0	16.5	0.0	1.9
KPJ HEALTHCARE	OP	5.00	4.20	792	1.30	12/10	19.8	16.8	14.8	15.5	1.1	14.6	11.6	2.0	11.8
BANGKOK DUSIT MD	NR		67.50	3,397	5.06	12/10	35.9	25.1	21.8	28.4	0.9	22.7	14.3	1.8	10.4
BUMRUNGRAD HOS	NR		39.75	943	1.04	12/10	23.0	20.3	18.8	10.6	1.9	14.6	11.2	2.5	17.8
BANGKOK CHAIN H	NR		6.30	409	0.59	12/10	19.9	17.8	15.7	12.7	1.4	10.2	9.5	3.4	19.0
APOLLO HOSPITALS	NR		519.80	1,403	1.29	03/11	35.0	28.4	23.6	21.9	1.3	17.9	14.7	0.9	8.2
Average							31.2	21.7	18.7		1.1	18.7	13.0	1.8	11.5

Note: Prices as at 31 October 2011

Source: Company, Bloomberg consensus estimates for non-rated stocks, Standard Chartered Research estimates for rated stocks

Absolute valuation

DCF shows fair value of SGD3.58 per share and offers 59% upside

We believe for long-term investors, a DCF valuation better reflects the future growth opportunities for the group. Our DCF valuation shows a fair value of SGD3.58 per share offering potential upside of 59%.



Fig 5: DCF valuation

SGDm	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
EBIT	53	59	68	78	89	105	125	144	166	190	218
EBIT (1-tax)	44	49	56	65	74	87	103	119	137	158	181
(+) Depreciation and amort.	7	7	12	13	15	15	15	16	16	16	17
(-) Change in working capital	(3)	(1)	2	3	3	4	5	4	5	5	6
(-) Capital expenditure	(5)	(117)	(48)	(38)	(7)	(7)	(8)	(8)	(8)	(9)	(9)
Unlevered free cash flow	43	(62)	23	43	85	99	116	131	150	171	195
Present Value of FCF's		(61)	21	36	65	69	74	77	81	85	88
Terminal value		-	-	-	-	-	-	-	-	-	2,838

	2012E	WACC assumptions
DCF of operations	595	Risk-free rate 4.00%
NPV of the terminal value	1,289	Cost of debt 5.00%
Total value of operations	1,884	Equity risk premium 5.00%
Net cash/(debt)	9	Tax rate 17%
Equity value	1,893	Target debt to firm value 0.00%
Shares outstanding	528	Equity beta 1.00
Fair value per share (SGD)	3.58	Cost of debt (after tax) 4.15%
Current price (SGD)	2.25	Cost of equity 9.00%
Upside/(downside)	59%	WACC 9.00%
		Terminal growth rate 2.0%

Source: Company, Standard Chartered Research estimates

Fig 6: Sensitivity of fair value

Terminal growth	WACC					
	8.0%	8.5%	9.0%	9.5%	10.0%	
1.0%	3.84	3.53	3.26	3.02	2.81	
1.5%	4.05	3.71	3.41	3.15	2.92	
2.0%	4.30	3.92	3.58	3.30	3.05	
2.5%	4.60	4.16	3.78	3.46	3.19	
3.0%	4.96	4.45	4.02	3.66	3.35	

Source: Standard Chartered Research estimates



Income statement (\$m)					
Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	219	239	272	311	359
Gross profit	178	195	222	254	293
SG&A	(117)	(128)	(145)	(170)	(196)
Other income	1	3	1	1	1
Other expenses	(16)	(17)	(16)	(14)	(13)
EBIT	45	53	62	72	85
Net interest	(0)	0	(0)	(0)	(0)
Associates	0	0	0	0	0
Other non operational	0	0	0	0	0
Exceptional items	-	-	-	-	-
Pretax profit	45	53	61	71	85
Taxation	(7)	(8)	(9)	(10)	(12)
Minority interests	(0)	(0)	(0)	(0)	(0)
Exceptional items after tax	-	-	-	-	-
Net profit	38	45	52	61	72
Net profit adj	38	45	52	61	72
EBITDA	52	60	69	83	98
EPS (\$)	0.07	0.09	0.10	0.12	0.14
EPS adj (\$)	0.07	0.09	0.10	0.11	0.13
DPS (\$)	0.00	0.00	0.00	0.00	0.00
Avg fully diluted shares (m)	524	532	536	536	536

Balance sheet (\$m)					
Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	74	107	43	47	60
Short term investments	1	0	0	0	0
Accounts receivable	24	26	30	34	39
Inventory	5	5	6	7	8
Other current assets	0	0	0	0	0
Total current assets	104	138	79	87	107
PP&E	146	144	254	290	314
Intangible assets	0	0	0	0	0
Associates and JVs	0	0	0	0	0
Other long term assets	86	89	89	89	89
Total long term assets	232	233	343	379	403
Total assets	337	372	422	466	510
Short term debt	5	5	20	20	10
Accounts payable	52	51	54	62	72
Other current liabilities	9	10	10	10	10
Total current liabilities	65	65	84	91	91
Long term debt	20	18	18	18	18
Convertible bonds	-	-	-	-	-
Deferred tax	1	2	2	2	2
Other long term liabilities	0	0	0	0	0
Total long term liabilities	21	20	20	20	20
Total liabilities	87	85	103	111	111
Shareholders' funds	250	286	318	354	397
Minority interests	0	1	1	1	1
Total equity	250	287	319	355	399
Total liabilities and equity	337	372	422	466	510
Net debt (cash)	(50)	(85)	(5)	(9)	(32)
Year end shares (m)	520	526	528	528	528

Cash flow statement (\$m)					
Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	45	53	62	72	85
Depreciation & amortisation	7	7	7	12	13
Net interest	(0)	0	0	(0)	(0)
Tax paid	(6)	(7)	(9)	(10)	(12)
Changes in working capital	1	(3)	(1)	3	3
Others	1	(1)	(0)	(0)	(0)
Cash flow from operations	47	50	59	75	89
Capex	(4)	(5)	(117)	(48)	(38)
Acquisitions	0	0	0	0	0
Disposals	0	2	0	0	0
Others	0	0	0	0	0
Cash flow from investing	(4)	(4)	(117)	(48)	(38)
Dividends	(13)	(16)	(21)	(24)	(29)
Issue of shares	1	4	0	0	0
Change in debt	(2)	(1)	15	0	(10)
Other financing cash flow	(0)	0	0	0	0
Cash flow from financing	(14)	(13)	(6)	(24)	(39)
Change in cash	30	33	(64)	4	13
Exchange rate effect	0	0	0	0	0
Free cash flow	43	44	(58)	28	52

Financial ratios and other					
Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	81.5	81.6	81.6	81.6	81.6
EBITDA margin (%)	23.9	25.1	25.2	26.8	27.4
EBIT margin (%)	20.8	22.2	22.6	23.0	23.6
Net margin adj (%)	17.3	18.9	19.2	19.5	20.1
Effective tax rate (%)	15.6	14.3	14.3	14.3	14.3
Sales growth (%)	8.9	9.4	13.8	14.3	15.5
Net income growth (%)	20.1	19.5	15.5	16.3	18.7
EPS growth (%)	19.6	18.5	14.6	16.0	18.7
EPS growth adj (%)	20.0	17.8	14.5	16.3	18.7
DPS growth (%)	12.5	22.2	-27.8	15.9	18.7
Efficiency ratios					
ROE (%)	16.1	16.9	17.3	18.1	19.2
ROCE (%)	17.6	18.3	19.1	20.1	21.4
Asset turnover (x)	0.7	0.7	0.7	0.7	0.7
Op cash / EBIT (x)	1.0	0.9	1.0	1.1	1.1
Depreciation / CAPEX (x)	1.8	1.3	0.1	0.2	0.4
Inventory days	45.1	42.9	39.5	39.4	39.2
Accounts receivable days	41.1	38.4	37.4	37.3	37.1
Accounts payable days	465.7	426.0	382.3	369.4	367.6
Leverage ratios					
Net gearing (%)	-19.9	-29.5	-1.6	-2.5	-7.9
Debt/capital (%)	-	-	-	-	-
Interest cover (x)	110.9	221.6	217.5	201.7	275.2
Debt/EBITDA (x)	-	-	-	-	-
Current ratio (x)	1.6	2.1	0.9	1.0	1.2
Valuation					
EV/Sales (x)	2.4	3.8	4.3	3.8	3.2
EV/EBITDA (x)	9.9	15.3	17.2	14.2	11.8
EV/EBIT (x)	11.4	17.3	19.2	16.5	13.6
PER (x)	14.6	21.7	22.7	19.6	16.5
PER adj (x)	14.8	22.0	23.1	19.8	16.7
PBR (x)	3.0	4.4	3.7	3.4	3.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Other					
Healthcare services	89	94	105	115	124
Hospital services	130	145	167	196	235
Investment holdings	0	0	0	0	0

Source: Company, Standard Chartered Research estimates



Disclosures appendix

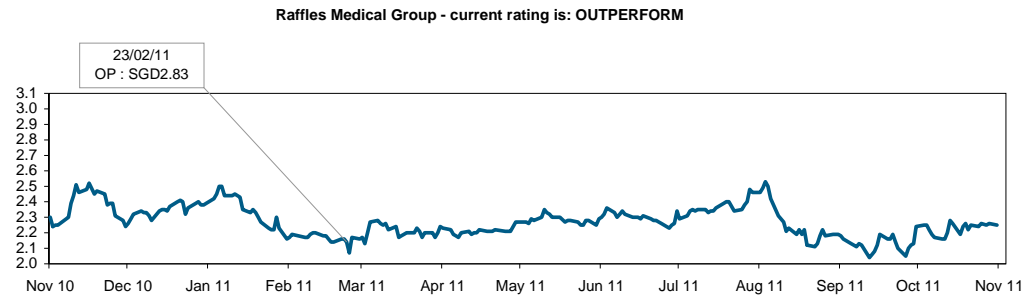
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Company Raffles Medical Group

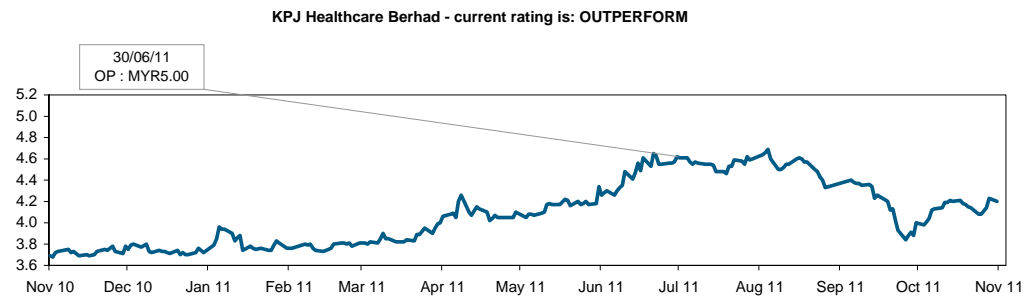
As at the disclosure date, the following applies:



Source: FactSet prices, SCB ratings and price targets

Company KPJ Healthcare Berhad

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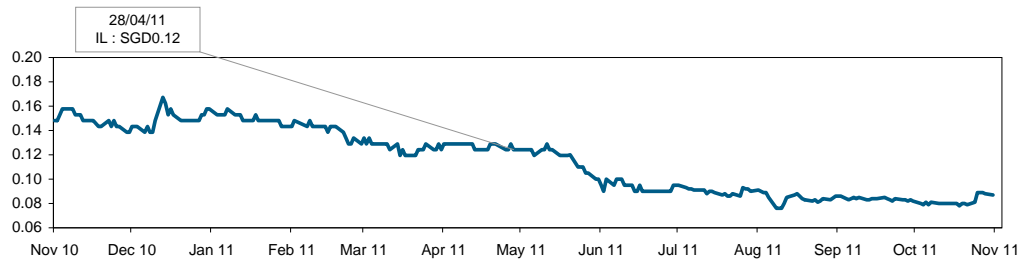
Source: FactSet prices, SCB ratings and price targets

Company Healthway Medical Corp. Ltd.

As at the disclosure date, the following applies:



Healthway Medical Corp. Ltd. - current rating is: IN-LINE



Source: FactSet prices, SCB ratings and price targets

Recommendation Distribution and Investment Banking Relationships

	% of covered companies currently assigned this rating	% of companies assigned this rating with which SCB has provided investment banking services over the past 12 months
OUTPERFORM	61.4%	13.8%
IN-LINE	30.3%	11.9%
UNDERPERFORM	8.3%	12.8%

As of 30 September 2011

Research Recommendation

Terminology	Definitions
OUTPERFORM (OP)	The total return on the security is expected to outperform the relevant market index by 5% or more over the next 12 months
IN-LINE (IL)	The total return on the security is not expected to outperform or underperform the relevant market index by 5% or more over the next 12 months
UNDERPERFORM (UP)	The total return on the security is expected to underperform the relevant market index by 5% or more over the next 12 months

SCB uses an investment horizon of 12 months for its price targets.

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