

⊙ Action

Raffles Medical (RMG)'s 1Q10 results were in-line with our expectations; seasonally weak 1Q net profit met 20% of our FY10 forecast. Most notably, foreign patient volume increased 24% y-y, which suggests possible pent-up demand from the region post-crisis. We raise our PT to S\$1.95 on a target multiple of 21x FY10F earnings, pegged at a mean discount to Parkway. Maintain BUY.

⚡ Catalysts

Key possible near-term catalysts include: 1) potential capital management (net cash of S\$35mn as of 3Q09); and 2) growth in local patients, which saw a slight decline in 9M09, along with 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.

Consistent performance

① Strong growth in foreign patient volume

RMG's 1Q10 results were largely in-line with our expectations — 10.2% revenue growth achieved on the back of strong growth in hospital services (+12%), moderated by slower growth in its primary care network (+8.8%). In particular, foreign patient volume increased 24% y-y, which reaffirms our view of possible pent-up demand from foreign patients in the region post-crisis. Management remains upbeat on outlook, citing the strong rebound in Singapore's economy.

② Rising staff costs, but should be contained

The increase in staff costs (+11% y-y) ran ahead of revenue growth for the first time, in part due to a reduction in the jobs credit grant and conservative bonus provisioning in 1Q. Management believes the accounting effect should be smoothed out in coming quarters and continues to guide for overall staff costs to lag revenue growth — a key efficiency metric that management tracks closely.

③ Regional expansion in sight?

RMG recently incorporated a wholly foreign-owned entity in Shanghai for management consultancy, which may also be used as a vehicle for a potential JV partnership in China. The group has also submitted a proposal in response to the Hong Kong government's intent to release four plots of land for private hospital development.

④ BUY; premium valuation backed by strong EPS growth

We maintain our BUY rating on Raffles and increase our PT to S\$1.95 (21x target P/E), backed by our DCF-based intrinsic value of S\$1.9-2.9 and an EPS CAGR of 18% over 2009-12F. A key possible re-rating catalyst includes regional expansion at reasonable valuations.

Closing price on 23 Apr	S\$1.67
Price target	S\$1.95
	(from S\$1.66)
Upside/downside	16.7%
Difference from consensus	14.6%
FY11F net profit (S\$mn)	54.7
Difference from consensus	11.0%
Source: Nomura	

Nomura vs consensus

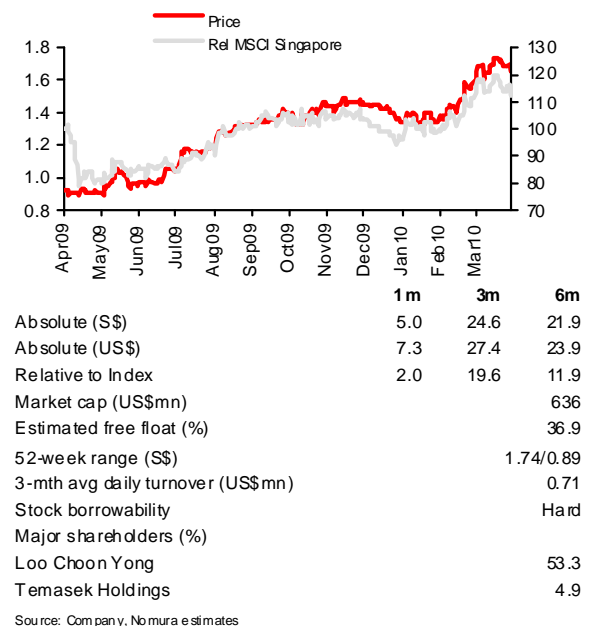
Our revenue forecasts are in-line, but our earnings estimates are slightly ahead of the Street's, owing to our recognition of RMG's significant operating leverage

Key financials & valuations

31 Dec (S\$mn)	FY09	FY10F	FY11F	FY12F
Revenue	218.6	248.2	279.4	298.5
Reported net profit	37.1	44.9	54.7	61.8
Normalised net profit	37.1	44.9	54.7	61.8
Normalised EPS (S\$)	0.071	0.086	0.104	0.118
Norm. EPS growth (%)	18.5	21.0	21.7	13.0
Norm. P/E (x)	23.6	19.5	16.0	14.2
EV/EBITDA (x)	15.9	13.0	10.6	9.1
Price/book (x)	3.5	3.1	2.8	2.5
Dividend yield (%)	1.8	2.1	2.4	2.4
ROE (%)	15.7	17.1	18.6	18.6
Net debt/equity (%)		net cash	net cash	net cash
Earnings revisions				
Previous norm. net profit		44.8	53.9	na
Change from previous (%)		0.3	1.4	na
Previous norm. EPS (S\$)		0.084	0.101	na

Source: Company, Nomura estimates

Share price relative to MSCI Singapore



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1Q10 results

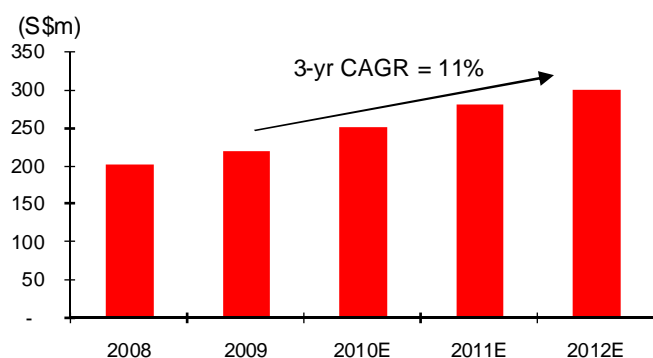
Maintain BUY

Exhibit 1. 1Q10 results and 2010-12F forecasts

	1Q09	1Q10	2010F	2011F	2012F	Remarks
Revenue	51	56	248	279	298	
Hospital services	na	na	151	173	185	1Q10: +12% y-y
Healthcare Services	na	na	97	106	114	1Q10: +8.8%y-y
Operating Cost	(41)	(45)	(194)	(215)	(226)	
Inventories + consumables used	(5.4)	(6)	(28)	(31)	(33)	
% Revenue	10.6%	11.4%	11.2%	11.2%	11.2%	
Staff costs	(24.9)	(28)	(117)	(130)	(136)	1Q10: spike due to reduction in jobs credit & conservative bonus provisioning every first quarter of the year
% Revenue	48.9%	49.2%	47.3%	46.5%	45.5%	Operating leverage
Operating lease expenses	(1.2)	(1)	(5)	(6)	(6)	
% Revenue	2.4%	2.4%	2.2%	2.0%	1.9%	Operating leverage
Purchased & contracted services	(3.8)	(4)	(18)	(20)	(22)	
% Revenue	7.5%	6.8%	7.3%	7.3%	7.3%	
Other operating expenses ex-bad debt	(3.9)	(4)	(17)	(20)	(21)	
% Revenue	7.7%	6.9%	7.0%	7.0%	7.0%	
Allowance for doubtful receivable (bad debt)	(0.3)	(0)	(1)	(1)	(1)	
% Revenue	0.61%	0.60%	0.51%	0.50%	0.50%	
Depreciation/amortization	(2)	(2)	(7)	(7)	(7)	Operating leverage
Core EBIT	10	11	54	64	72	
Core EBIT margin	18.9%	19.8%	21.7%	23.0%	24.2%	Consistent margin expansion driven by operating leverage
Core EBITDA	11	13	61	71	79	
Core EBITDA margin	22.3%	22.8%	24.5%	25.5%	26.6%	
Net earnings	7.8	9.1	44.9	54.7	61.8	1Q10 met 20% of FY10 forecast; 1Q traditionally a weak quarter due to festive season and short February
y-y%		16.4	18.6	21.7	13.1	

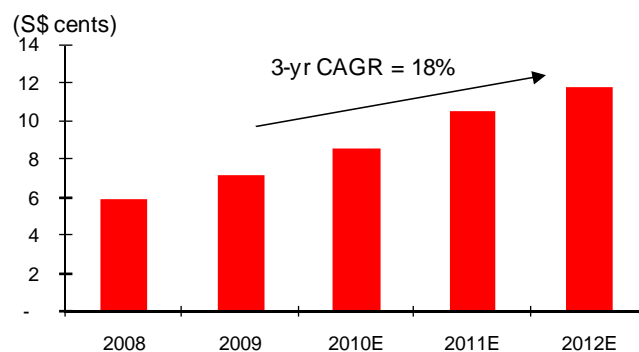
Source: Company data, Nomura estimates

Exhibit 2. Revenue trend



Source: Company data, Nomura estimates

Exhibit 3. EPS trend



Source: Company data, Nomura estimates

DCF-based intrinsic value underscores growth potential

With high operating margins (25% EBITDA margin), low capex (S\$4-6mn maintenance capex/year) and a negative cash cycle, Raffles Medical is, in our view, a cash cow that generates about S\$50mn FCF annually. Another key investment merit, in our view, is that the group is able to expand its bed capacity with minimal capex to meet rising demand for private healthcare from the region. Our DCF-based intrinsic value captures our assumptions on its bed expansion — from 200 in 2010F to 280 in 2016F, and an average optimal occupancy of 60%.

Exhibit 4. DCF valuation – Raffles Medical

(S\$mn)	FY10F	FY11F	FY12F	FY13F	FY14F	FY15F	FY16F
Inpatient revenue	93	108	114	123	133	143	155
# bed - Operational	200	225	225	250	250	280	280
Inpatient admissions	15,607	17,275	17,841	18,565	19,509	20,440	21,497
% chg	8%	11%	3%	4%	5%	5%	5%
Occ (%)	62%	61%	63%	59%	62%	58%	61%
Avg RevPPD (S\$)	2,064	2,147	2,211	2,278	2,346	2,416	2,489
Est. outpatient revenue	57	66	70	69	75	81	87
Healthcare revenue	97	106	114	122	129	133	137
Overall revenue growth (%)	14%	13%	7%	5%	7%	6%	6%
Total EBITDA	61	71	79	83	91	96	103
Implied EBITDA margin	24.5%	25.5%	26.6%	26.4%	27.0%	27.0%	27.0%
- Working Capital	2	2	2	2	2	2	3
- Capex	(5)	(6)	(5)	(7)	(7)	(9)	(9)
- Tax	(9)	(11)	(13)	(13)	(15)	(15)	(17)
FCF	49	56	63	65	72	74	80
WACC	5.9%	6.7%	7.4%	8.2%			
Terminal Growth (%)	1.5%						
Terminal Value	1,705	1,440	1,244	1,092			
Enterprise Value (2010F)	1,439	1,210	1,042	913			
Net (Debt)/Cash	78						
Equity value (2010F)	1,517	1,288	1,119	990			
Equity Value/Share	2.89	2.46	2.13	1.89			

Source: Nomura estimates

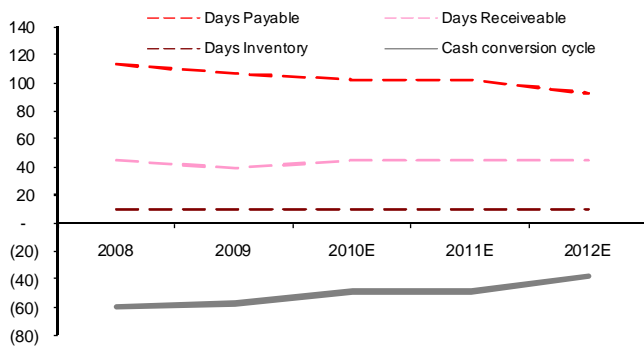
Valuation methodology and risks

We value Raffles Medical based on a 21x FY10F P/E (previously 19x, methodology unchanged), which is at a mean relative P/E discount to Parkway's (PWAY SP, S\$3.33, NEUTRAL) current core P/E of 25x. Our price target of S\$1.95 is derived after adding an estimated net cash/share of S\$0.15 (Dec 10F). We believe an earnings-based methodology reflects the company's strong growth profile, backed by our estimated DCF-based intrinsic value range of S\$1.89-2.89/share.

Key risks to our call: 1) the group's ability to attract and retain medical professionals; and 2) regulatory risks in Singapore.

Franchise value backed by robust financial performance

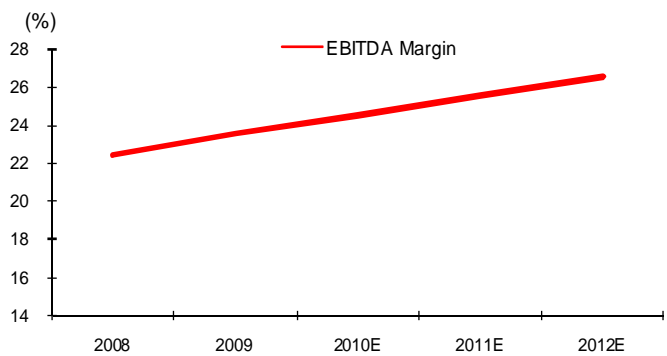
Exhibit 5. Cash conversion cycle



Negative cash conversion cycle a result of 90-day credit policy with suppliers and effective receivables management

Source: Company data, Nomura estimates

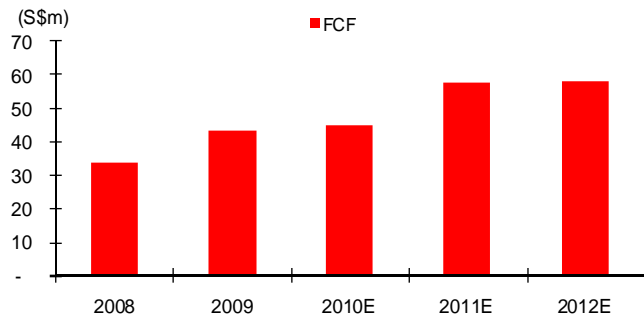
Exhibit 6. EBITDA margin



Uptrend in margin driven by operating leverage; approximately 50% of cost base is fixed, and excess capacity to drive top-line

Source: Company data, Nomura estimates

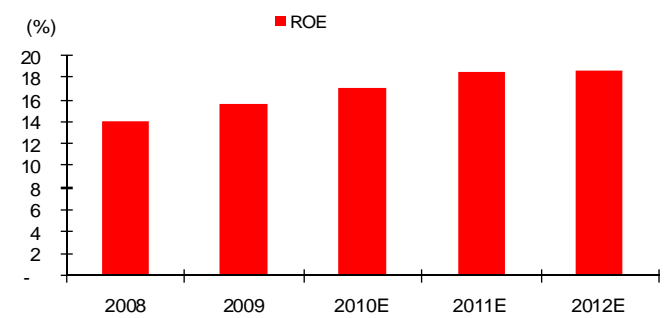
Exhibit 7. Free cashflow



RMG generates significant FCF of S\$45-60mn/year and trades at an FCF yield of 5%, supporting stable 2% dividend yield

Source: Company data, Nomura estimates

Exhibit 8. ROE



Consistent ROE improvement – 14% in FY08 to 19% in FY12F

Source: Company data, Nomura estimates

Financial statements

Income statement (\$m)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Revenue	200.8	218.6	248.2	279.4	298.5
Cost of goods sold	(162.3)	(173.9)	(194.3)	(215.2)	(226.4)
Gross profit	38.5	44.7	53.9	64.2	72.1
SG&A	-	-	-	-	-
Employee share expense	-	-	-	-	-
Operating profit	38.5	44.7	53.9	64.2	72.1
EBITDA	45.1	51.6	60.9	71.3	79.4
Depreciation	(6.6)	(6.9)	(7.0)	(7.1)	(7.2)
Amortisation	-	-	-	-	-
EBIT	38.5	44.7	53.9	64.2	72.1
Net interest expense	(0.4)	(0.4)	0.4	1.9	2.6
Associates & JCEs	-	-	-	-	-
Other income	-	-	-	-	-
Earnings before tax	38.1	44.3	54.4	66.1	74.7
Income tax	(6.7)	(7.0)	(9.2)	(11.2)	(12.7)
Net profit after tax	31.4	37.3	45.1	54.9	62.0
Minority interests	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Other items	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	31.3	37.1	44.9	54.7	61.8
Extraordinary items	-	-	-	-	-
Reported NPAT	31.3	37.1	44.9	54.7	61.8
Dividends	(12.9)	(15.6)	(18.2)	(20.7)	(20.7)
Transfer to reserves	18.4	21.6	26.8	33.9	41.1
Valuation and ratio analysis					
FD normalised P/E (x)	27.9	23.6	19.5	16.0	14.2
FD normalised P/E at price target (x)	32.6	27.5	22.7	18.7	16.5
Reported P/E (x)	27.9	23.6	19.5	16.0	14.2
Dividend yield (%)	1.5	1.8	2.1	2.4	2.4
Price/cashflow (x)	21.8	18.5	17.8	13.8	13.8
Price/book (x)	3.9	3.5	3.1	2.8	2.5
EV/EBITDA (x)	18.9	15.9	13.0	10.6	9.1
EV/EBIT (x)	22.2	18.4	14.7	11.8	10.0
Gross margin (%)	19.2	20.4	21.7	23.0	24.2
EBITDA margin (%)	22.5	23.6	24.5	25.5	26.6
EBIT margin (%)	19.2	20.4	21.7	23.0	24.2
Net margin (%)	15.6	17.0	18.1	19.6	20.7
Effective tax rate (%)	17.6	15.8	17.0	17.0	17.0
Dividend payout (%)	41.3	41.9	40.4	37.9	33.6
Capex to sales (%)	3.1	1.8	1.4	2.0	1.7
Capex to depreciation (x)	0.9	0.6	0.5	0.8	0.7
ROE (%)	14.8	15.7	17.1	18.6	18.6
ROA (pretax %)	14.6	16.9	20.4	23.9	26.7
Growth (%)					
Revenue	19.0	8.9	13.5	12.6	6.8
EBITDA	39.0	14.3	18.0	17.1	11.3
EBIT	36.4	16.1	20.7	19.1	12.4
Normalised EPS	26.8	18.5	21.0	21.7	13.0
Normalised FDEPS	26.8	18.5	21.0	21.7	13.0
Per share					
Reported EPS (S\$)	0.06	0.07	0.09	0.10	0.12
Norm EPS (S\$)	0.06	0.07	0.09	0.10	0.12
Fully diluted norm EPS (S\$)	0.06	0.07	0.09	0.10	0.12
Book value per share (S\$)	0.43	0.48	0.53	0.60	0.68
DPS (S\$)	0.03	0.03	0.04	0.04	0.04

Source: Nomura estimates

Margin expansion driven by operating leverage

Cashflow (\$\$mn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
EBITDA	45.1	51.6	60.9	71.3	79.4
Change in working capital	1.0	(0.0)	(2.2)	1.5	(6.1)
Other operating cashflow	(6.0)	(4.4)	(9.5)	(9.3)	(10.1)
Cashflow from operations	40.1	47.2	49.3	63.5	63.2
Capital expenditure	(6.1)	(3.9)	(3.5)	(5.5)	(5.0)
Free cashflow	33.9	43.3	45.8	58.0	58.2
Reduction in investments	0.7	(0.6)	-	-	-
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	0.1	0.8	(0.7)	-	0.2
Addition in other LT liabilities	0.0	0.7	-	-	-
Adjustments	1.2	-	0.0	-	-
Cashflow after investing acts	36.0	44.2	45.1	58.0	58.5
Cash dividends	(12.9)	(13.0)	(18.2)	(20.7)	(20.7)
Equity issue	1.3	1.3	0.6	-	-
Debt issue	0.9	(2.0)	(8.8)	(4.4)	(3.9)
Convertible debt issue	-	-	-	-	-
Others	-	-	-	-	-
Cashflow from financial acts	(10.7)	(13.7)	(26.3)	(25.1)	(24.6)
Net cashflow	25.2	30.6	18.8	32.8	33.8
Beginning cash	19.7	44.5	74.9	93.4	126.2
Ending cash	45.0	75.1	93.7	126.2	160.0
Ending net debt	(17.9)	(50.4)	(77.7)	(114.9)	(152.4)

Source: Nomura estimates

Significant FCF owing to low capex and positive working capital (FY10F FCF yield of 7%)

Balance sheet (\$\$mn)					
As at 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Cash & equivalents	44.5	74.9	93.4	126.2	159.8
Marketable securities	-	-	-	-	-
Accounts receivable	24.9	24.3	31.0	34.9	37.3
Inventories	4.8	5.3	5.6	6.3	6.7
Other current assets	-	-	-	-	-
Total current assets	74.2	104.5	129.9	167.4	203.8
LT investments	84.4	85.0	85.0	85.0	85.0
Fixed assets	150.3	146.4	144.0	142.4	140.2
Goodwill	-	-	-	-	-
Other intangible assets	0.3	0.4	0.4	0.4	0.4
Other LT assets	1.3	0.5	1.2	1.2	0.9
Total assets	310.4	336.8	360.5	396.3	430.3
Short-term debt	4.6	4.5	2.5	2.5	3.0
Accounts payable	51.5	52.0	56.0	62.1	58.8
Other current liabilities	9.3	8.7	9.6	9.6	9.6
Total current liabilities	65.4	65.2	68.1	74.2	71.4
Long-term debt	22.0	20.0	13.2	8.8	4.4
Convertible debt	-	-	-	-	-
Other LT liabilities	0.7	1.4	1.4	1.4	1.4
Total liabilities	88.2	86.7	82.7	84.4	77.3
Minority interest	0.3	0.4	0.5	0.7	0.8
Preferred stock	-	-	-	-	-
Common stock	171.3	172.7	173.3	173.3	173.3
Retained earnings	50.6	77.1	103.9	137.8	178.9
Proposed dividends	-	-	-	-	-
Other equity and reserves	-	-	-	-	-
Total shareholders' equity	221.9	249.8	277.2	311.1	352.2
Total equity & liabilities	310.4	336.8	360.5	396.3	430.3

Liquidity (x)

Current ratio	1.13	1.60	1.91	2.26	2.85
Interest cover	105.4	109.0	na	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	41.1	40.7	43.1	44.3
Days inventory	9.6	10.5	10.2	10.0	10.5
Days payable	112.4	108.6	101.4	100.2	97.8
Cash cycle	(61.7)	(57.0)	(50.6)	(47.0)	(43.0)

Source: Nomura estimates

ANALYST CERTIFICATIONS

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Raffles Medical Sgd0.10	RFMD SP	1.67 SGD	23 Apr 2010	Buy	

Previous Ratings

Issuer	Previous Rating	Date of change
Raffles Medical Sgd0.10	No Rating	03 Mar 2009

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Stocks:

- A rating of "1", or "**Buy**", indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
 - A rating of "2", or "**Neutral**", indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
 - A rating of "3", or "**Reduce**", indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
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Sectors:

A "**Bullish**" stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months.

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.

Benchmarks are as follows: **United States:** S&P 500; **Europe:** Dow Jones STOXX® 600; **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia.

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008):

Stocks:

- A rating of "1", or "**Strong buy**", indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.
- A rating of "2", or "**Buy**", indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "3", or "**Neutral**", indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
- A rating of "4", or "**Reduce**", indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "5", or "**Sell**", indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.
- Stocks labeled "**Not rated**" or shown as "**No rating**" are not in Nomura's regular research coverage. Nomura might not publish additional research reports concerning this company, and it undertakes no obligation to update the analysis, estimates, projections, conclusions or other information contained herein.

Sectors:

A "**Bullish**" stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.

A "**Neutral**" stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.

A "**Bearish**" stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Japan:** TOPIX; **United States:** S&P 500, MSCI World

Technology Hardware & Equipment; **Europe,** by sector — *Hardware/Semiconductors:* FTSE W Europe IT Hardware; *Telecoms:* FTSE W Europe Business Services; *Business Services:* FTSE W Europe; *Auto & Components:* FTSE W Europe Auto & Parts; *Communications equipment:* FTSE W Europe IT Hardware;

Ecology Focus: Bloomberg World Energy Alternate Sources; **Global Emerging Markets:** MSCI Emerging Markets ex-Asia.

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 $(\text{Fair Value} - \text{Current Price}) / \text{Current Price}$, 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.

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