

Raffles Medical Group

Still looking good

OUTPERFORM	Maintained
S\$1.26	@06/04/08
	Target: S\$1.65
	Hospitals

RFMD SP / RAFG.SI

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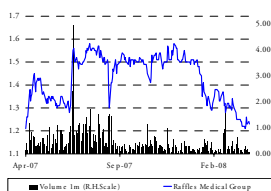
- Means testing in Jan 09.** The government has unveiled the parameters for means testing, which will be implemented in all public hospitals in Jan 09. Means testing is expected to reduce subsidies for the bulk of middle-income Singaporeans and permanent residents in public hospitals. With two-thirds of RFMD's patients being Singapore residents, compared to Parkway's 40%, we expect RFMD to be a greater beneficiary, as more middle-income patients seek private healthcare now that the cost differential between private and public healthcare for this group has narrowed.
- Equity fund-raising unlikely in near future.** We do not anticipate significant capex outlay this year beyond maintenance capex and possible overseas expansion into China via a medical centre, which is likely to be funded by internal cash and debt.
- Maintain Outperform; lower target price of S\$1.65 (from S\$1.71).** We have trimmed our FY08-10 EPS estimates by 2.0-3.7% as we fine-tune our inpatient revenue growth assumptions and increase our share base by 0.1% due to the exercise of employee share options. Following this, our target price falls to S\$1.65, still based on 22.5x CY09 P/E, or a 10% discount to our 25x target for Parkway's core healthcare operations, to account for RFMD's current exposure to Singapore only, lower trading liquidity and smaller market capitalisation. Maintain Outperform on the back of its growth momentum.

Financial summary

FYE Dec	2006	2007	2008F	2009F	2010F
Revenue (S\$ m)	134.2	168.7	202.2	235.8	268.8
EBITDA (S\$ m)	20.9	30.6	43.7	53.3	63.0
EBITDA margins (%)	15.5%	18.2%	21.6%	22.6%	23.4%
Pretax profit (S\$ m)	20.0	41.4	36.6	46.2	56.0
Net profit (S\$ m)	15.7	35.9	29.9	37.8	45.8
EPS (S cts)	3.8	7.4	5.8	7.3	8.9
EPS growth (%)	27.9%	91.2%	(21.1%)	26.2%	21.2%
P/E (x)	32.7	17.1	21.7	17.2	14.2
Core EPS (S cts)	3.8	4.8	5.8	7.3	8.9
Core EPS growth (%)	27.9%	24.6%	21.1%	26.2%	21.2%
Core P/E (x)	32.7	26.3	21.7	17.2	14.2
FD core EPS (S cts)	3.8	4.7	5.8	7.3	8.9
FD core P/E (x)	33.4	26.7	21.7	17.2	14.2
Gross DPS (S cts)	4.0	2.6	5.2	7.3	8.9
Dividend yield (%)	3.2%	2.1%	4.1%	5.8%	7.1%
P/BV (x)	4.6	3.2	3.2	3.2	3.2
ROE (%)	14.2%	22.9%	14.8%	18.5%	22.5%
Net gearing (%)	N/A	2.7%	N/A	N/A	N/A
Net cash per share (S\$)	0.10	N/A	0.00	0.02	0.04
P/FCFE (x)	29.5	58.4	19.7	13.6	11.7
EV/EBITDA (x)	20.1	20.2	14.9	12.0	10.0
% change in EPS estimates			(2.0)	(3.7)	(3.5)
CIMB/Consensus (x)			1.02	1.06	0.98

Source: Company, CIMB-GK Research, Bloomberg

Price chart



Source: Bloomberg

Market capitalisation & share price info

Market cap	S\$650m/US\$471m	Share price perf. (%)	1M	3M	12M
12-mth price range	S\$1.58/S\$1.21	Relative	(12.0)	(9.1)	3.4
3-mth avg daily volume	0.3m	Absolute	(4.6)	(16.0)	0.0
# of shares (m)	516	Major shareholders			% held
Est. free float (%)	35.0	Dr Loo Choon Yong (direct and deemed)			49.9
Conv. secs (m)					N/A
Conv. price ()					N/A

Source: Company, CIMB-GK Research, Bloomberg

Update

Means testing to be implemented in Jan 09. Earlier last month, the government unveiled the parameters for means testing which will be implemented in all public hospitals in Jan 09: Singaporeans with a monthly income of S\$3,200 and below will continue to enjoy full subsidies of 80% and 65% for Class C and Class B2 wards respectively; those with a monthly income of S\$5,201 and above will receive subsidies of 65% and 50% for Class C and Class B2 wards respectively; and those with a monthly income of between S\$3,201 and S\$5,200 will have reduced subsidy entitlements, with the scale graduated at every S\$150 intervals. Economically inactive Singaporeans who live in private properties with annual values greater than S\$11,000 will also be subject to means testing. According to the government, 60% of Singaporeans, including all housewives, retirees and children living in HDB flats, will continue to enjoy full subsidies. In addition, subsidies for permanent residents will be 10% less than those for citizens. With some two-thirds of RFMD's patients being Singapore residents, compared to Parkway's 40%, we expect RFMD to be a greater beneficiary of means testing, as more middle-income patients seek private healthcare now that the cost differential between private and public healthcare has narrowed for this group of patients.

Spare capacity is its trump card. Occupancy rates at Raffles Hospital are only 40-60% of the 200 beds opened, out of its 380 licensed beds. In comparison, Parkway's three Singapore hospitals are operating near full capacities, which may constrain its growth in the short term, until its new 350-bed Novena hospital is up and running in mid-2011. With its spare capacity, RFMD can increase its patient load and bed rates to cater to demand. Should demand remain healthy, the group intends to add 50 beds this year. Assuming an increase of 50 beds a year, the hospital should be able to grow within its existing building without significant capex outlay over the next three years. While an additional 550 beds from the Khoo Teck Puat government hospital, 217 beds from the Farrer Park hospital (to be run by Singapore HealthPartners) and 350 beds from Parkway's Novena hospital are expected to come on stream in 2010-11, we expect the additional capacity to be easily taken up by rising demand for healthcare from an aging population, an immigration boom and growing medical tourists.

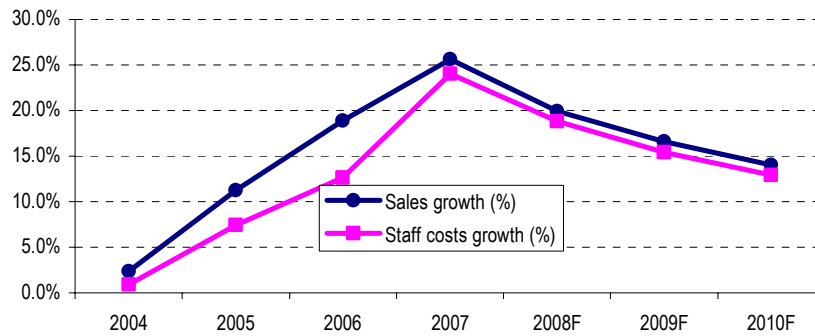
Shorter length of stay maximises average revenue per patient day. One of the reasons for the lower occupancy rates at Raffles Hospital is the shorter average length of stay of three days, compared to Parkway's 3.68 days. According to management, the highest revenue is generated during the first three days of stay. In addition, a shorter length of stay translates into faster patient-to-bed turnover and allows hospitals to increase patient loads.

Increasing value-added services in ambulatory medical centres and clinics. RFMD's network of 60 private GP clinics used to provide only family medicine and dental services. RFMD is exploring ways to expand the range of services offered at these clinics in heartland and high-traffic locations. For one, the new clinic at Terminal 3 houses a full service 24-hour medical centre with multi-disciplinary services in the areas of family medicine, health screening, occupational medicine, aesthetics, dentistry, obstetrics & gynaecology and emergency services.

Health insurance another avenue for RFMD. International Medical Insurers, RFMD's specialist healthcare insurer, had acquired more corporate and personal clients and grew strongly in FY07. Recent publicity on health insurance issues augurs well for IMI as it can tap the growing individual health insurance market on concerns of rising healthcare costs.

Successful cost-containment. Staff expenses generally form the biggest operating cost component for healthcare service providers. FY07 staff costs made up 62.2% of RFMD's operating expenses. RFMD has been able to contain its staff expenses thus far, as demonstrated by the trailing yoy growth in its staff costs vs. revenue growth over the past four years. Furthermore, with patient load expected to continue to increase, we believe there is further room for operating leverage and expect EBITDA margins to increase from 18.2% in FY07 to 23.4% in FY10.

Figure 1: RFMD: Yoy growth in staff costs vs. yoy revenue growth



Source: Company, CIMB-GK Research

In FY07, the two biggest operating cost components, staff costs and inventories & consumables, made up 37.7% and 30.8% respectively of Parkway's operating expenses. While Parkway had been able to contain its staff expenses over FY04-06, yoy growth in its staff costs exceeded its revenue growth in FY07, when staff costs grew 12.2% yoy while sales were flat. Excluding an S\$8.0m special bonus paid to non-executive staff out of the exceptional gains from the disposal of Singapore hospital properties to Parkway Life REIT (PREIT SP, S\$1.21, Not Rated), Parkway's staff costs still grew 8.7% yoy.

Figure 2: Parkway Holdings: Yoy growth in staff costs vs. yoy revenue growth



Source: Company, CIMB-GK Research

Equity fund-raising unlikely in the immediate future. RFMD is now slightly geared, after assuming debt to take on full ownership of the hospital building last year. We do not anticipate significant capex outlay this year, beyond the S\$3m-5m in maintenance capex as well as possible overseas expansion in fast-growing Chinese cities such as Shanghai and Beijing. Management had announced in 2006 that it would be establishing a presence in China within two years. We believe that its M&A plans should gain some traction this year. As its foray into China is likely to commence with a medical centre rather than a full-fledged hospital and it is likely to bring on partners, significantly less capital investment would be required. We believe that the expansion would be funded by internal cash as well as debt. This could result in the payment of ordinary dividends only. Management intends to honour its ordinary dividend payments, while the payment of special dividends would be contingent on its net cash position.

Figure 3: Segmental breakdown

S\$ m, FYE Dec	2007	2008F	2009F	2010F
Healthcare services	69.7	78.1	85.9	92.8
Hospital services	106.3	134.2	162.7	191.7
Investment holdings	2.9	2.9	2.9	2.9
Eliminations	(10.3)	(13.0)	(15.7)	(18.5)
Total revenue	168.7	202.2	235.8	268.8
Healthcare services	6.4	7.0	7.7	8.4
Hospital services	19.8	26.8	34.2	42.2
Investment holdings	2.1	2.1	2.1	2.1
Eliminations	N/A	N/A	N/A	N/A
Total operating profit	28.2	36.0	44.0	52.6

Source: Company, CIMB-GK Research

Risks

Increased regional competition, as more countries such as Thailand, Malaysia, India, the United Arab Emirates and South Korea are stepping up efforts to attract more foreign patients to their countries for medical treatment.

Economic downturn. A severe recession in the US could result in significantly slower economic growth in Singapore and the region, depressing healthcare demand. Patients may postpone non-emergency elective medical procedures.

Valuation and recommendation

Maintain Outperform with lower target price of S\$1.65 (from S\$1.71). We have trimmed our FY08-10 EPS estimates by 2.0-3.7% as we fine-tune our inpatient revenue growth assumptions and increase our share base by 0.1% due to the exercise of employee share options. Following this, our target price has been reduced to S\$1.65, still based on 22.5x CY09 P/E, or a 10% discount to our 25x target for Parkway's core healthcare operations, to account for RFMD's current exposure to Singapore only, lower trading liquidity and smaller market capitalisation.

Maintain Outperform on the back of its growth momentum, led by the positive fundamentals of an aging population, rising affluence, an immigration boom (increasing the number of non-Singaporeans who are not entitled to subsidised services at public hospitals), growing medical tourism and the eventual implementation of means testing. RFMD remains our top pick in the Singapore healthcare sector.

Figure 4: Sector comparisons

	Bloomberg ticker	Recom.	Price (Local)	Target price (Local)	Mkt cap (US\$ m)	Core P/E (x)	3-yr EPS CAGR (%)	P/BV (x)	ROE (%)	Div yield (%)	
						CY2008	CY2009	CY2008	CY2008	CY2008	
Raffles Medical	RFMD SP	O	1.26	1.65	471	21.7	17.2	23.5	3.2	14.8	4.1
Parkway	PWAY SP	U	3.23	2.83	1,805	21.7	20.2	(0.7)	1.8	11.9	4.6
Thomson Medical	THOM SP	N	0.63	0.77	132	14.4	12.1	20.8	1.9	13.2	4.9
Pacific Healthcare	PACH SP	U	0.29	0.39	58	16.8	9.5	48.3	1.3	11.1	2.4
Bumrungrad	BH TB	N	33.00	46.00	761	17.5	15.3	8.2	4.8	29.4	2.9
Simple average						18.4	14.8	20.0	2.6	16.1	3.8

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB-GK Research

Financial tables

PROFIT & LOSS

(S\$ m, FYE Dec)	2006	2007	2008F	2009F	2010F
Revenue	134	169	202	236	269
Operating expenses	(113)	(138)	(159)	(183)	(206)
EBITDA	21	31	44	53	63
Depreciation & amortisation	(3)	(4)	(6)	(6)	(6)
EBIT	17	26	37	47	57
Net interest & invt income	2	1	(1)	(1)	(1)
Associates' contribution	1	1	0	0	0
Exceptional items	0	13	0	0	0
Others	0	0	0	0	0
Pretax profit	20	41	37	46	56
Tax	(4)	(5)	(7)	(8)	(10)
Minority interests	0	0	0	0	0
Net profit	16	36	30	38	46
Adj. wt. shares (m)	408	487	516	516	516
Unadj. year-end shares (m)	413	516	516	516	516

KEY RATIOS

(FYE Dec)	2006	2007	2008F	2009F	2010F
Revenue growth (%)	18.9	25.6	19.9	16.6	14.0
EBITDA growth (%)	32.4	46.8	42.8	21.8	18.3
Pretax margins (%)	14.9	24.6	18.1	19.6	20.8
Net profit margins (%)	11.7	21.3	14.8	16.0	17.0
Interest cover (x)	N/A	N/A	49.3	62.0	74.9
Effective tax rates (%)	21.4	13.3	18.0	18.0	18.0
Net dividend payout (%)	105.2	36.0	90.0	100.0	100.0
Debtors turnover (days)	39.5	40.0	38.3	37.2	37.5
Stock turnover (days)	8.7	7.8	7.4	7.4	7.5
Creditors turnover (days)	74.0	84.1	85.1	78.0	78.8

BALANCE SHEET

(S\$ m, end Dec)	2006	2007	2008F	2009F	2010F
Fixed assets	20	234	228	221	215
Intangible assets	0	0	0	0	0
Other long-term assets	55	1	1	1	1
Total non-current assets	75	236	230	223	217
Cash and equivalents	42	20	26	36	46
Stocks	3	4	4	5	6
Trade debtors	17	20	22	26	29
Other current assets	14	1	1	1	1
Total current assets	76	44	53	67	82
Trade creditors	30	48	47	54	62
Short-term borrowings	2	25	25	25	25
Other current liabilities	6	7	7	7	7
Total current liabilities	38	80	79	86	94
Long-term borrowings	0	0	0	0	0
Other long-term liabilities	1	1	1	1	1
Total long-term liabilities	1	1	1	1	1
Shareholders' funds	113	201	204	204	204
Minority interests	0	0	0	0	1
NTA/share (S\$)	0.27	0.39	0.39	0.39	0.39

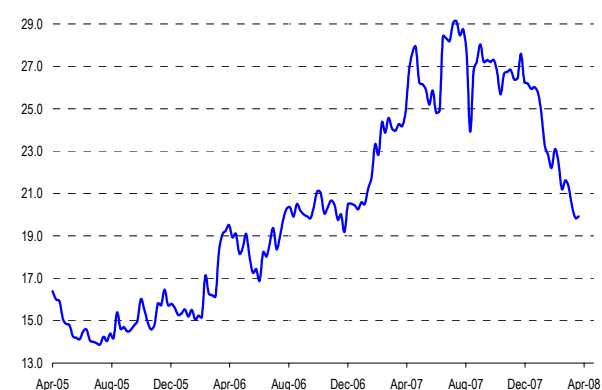
KEY DRIVERS

(FYE Dec)	2007	2008F	2009F	2010F
Revenue per patient bed (S\$)	531,585	536,901	542,270	547,693
Beds Opened (Beds)	200	250	300	350

CASH FLOW

(S\$ m, FYE Dec)	2006	2007	2008F	2009F	2010F
Pretax profit	20	41	37	46	56
Depreciation & non-cash adj.	3	4	11	11	11
Working capital changes	1	13	(4)	3	3
Cash tax paid	(2)	(4)	(7)	(8)	(10)
Others	(2)	(15)	0	0	0
Cash flow from operations	20	40	37	52	60
Capex	(2)	(4)	(4)	(4)	(4)
Net investments & sale of FA	(1)	14	0	0	0
Others	2	(63)	0	0	0
Cash flow from investing	(2)	(53)	(4)	(4)	(4)
Debt raised/(repaid)	0	23	0	0	0
Equity raised/(repaid)	5	69	0	0	0
Dividends paid	(16)	(18)	(27)	(38)	(46)
Cash interest & others	0	(84)	0	0	0
Cash flow from financing	(11)	(9)	(27)	(38)	(46)
Change in cash	7	(22)	6	10	10
Change in net cash/(debt)	7	(45)	6	10	10
Ending net cash/(debt)	40	(6)	0	10	20

12M - FORWARD FD CORE P/E (X)



Source: Company, CIMB-GK Research, Bloomberg

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RECOMMENDATION FRAMEWORK #1*

STOCK RECOMMENDATIONS

OUTPERFORM: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.

NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

TRADING SELL: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

* This framework only applies to stocks listed on the Singapore Stock Exchange, Bursa Malaysia, Stock Exchange of Thailand and Jakarta Stock Exchange.

RECOMMENDATION FRAMEWORK #2 **

STOCK RECOMMENDATIONS

OUTPERFORM: Expected positive total returns of 15% or more over the next 12 months.

NEUTRAL: Expected total returns of between -15% and +15% over the next 12 months.

UNDERPERFORM: Expected negative total returns of 15% or more over the next 12 months.

TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.

TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

*** This framework also applies to stocks listed on the Hong Kong Stock Exchange and China listings on the Singapore Stock Exchange.*